Review of default group insurance in superannuation

September 2017

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Scope

KPMG has been requested by the Insurance in Superannuation Working Group (ISWG) to undertake analysis into the costs and benefits of default group insurance in superannuation, and to evaluate the impact of potential changes to the current system to address current concerns that default group insurance may be unduly eroding retirement savings.

Some of the potential changes to default group insurance in superannuation being discussed by commentators and others include:

- removing or reducing default group insurance cover for younger members
- removing the duplication of group insurance cover
- changing group insurance from the current system of default (opt-out) to opt-in insurance cover.

In addition, KPMG was requested to provide high level commentary on global pension schemes including a comparison of these against the Australian superannuation system.

Approach

In undertaking our analysis of the impact of default group insurance in superannuation, we have reviewed key aspects of the current system and undertook modelling to project forward the insurance premium deductions of members of the superannuation system to age 65 and consider the overall impact on members' retirement savings. KPMG's analysis utilised data from the Australian Taxation Office (ATO), the Australian Prudential Regulation Authority (APRA), information from superannuation fund Product Disclosure Statements (PDS) and validated this against census data for reasonableness.

Findings

Our analysis and research indicates that, whilst there is a cost incurred by members for default group insurance cover in superannuation, and some members' retirement savings are affected more than others, notably low income earners, females and young people, when considered as a whole, there are a number of qualitative and quantitative benefits to the Australian population that result from insurance benefits being held within superannuation. To this end, decisions to remove or reduce access to this, or materially alter the structure of the system, could have significant consequences for the broader community.

As part of our analysis, we have considered the following:

Costs and benefits of default group insurance

The benefits to having default group insurance in superannuation include:

- greater insurance coverage for a larger proportion of the Australian population, thus helping to reduce Australia's well documented underinsurance issue
- in some instances, default group insurance in superannuation improves access to insurance for people in high risk occupations that would otherwise not be able to access insurance outside of superannuation
- default group insurance in superannuation provides higher insurance benefits compared to government safety net social security benefits, thus allowing people to take better care of their family and dependants in the event of death or disability than is otherwise possible
- in the 3 years to June 2016, approximately $13.8 billion was paid out in insurance benefits to members from superannuation funds, as is evident in Table 1 below.

Table 1: Number and value of insurance claims admitted and paid from superannuation (July 2013 - June 2016)

Cover type	Number of claims paid	Amount of claims paid ($' million)	Average benefit per claims
Death	53,298	6,644	124,657
TPD	48,937	5,045	103,092
IP	102,538	2,092	20,402
Total	**204,773**	**13,781**	

Approximately 50% of the benefits above relate to default insurance in superannuation.

- The benefits of default group insurance in super are further illustrated in the following cameos, Leon who made a claim for Total and Permanent Disablement (TPD), and Bob who made an Income Protection (IP) claim:

CAMEO: LEON (TPD Benefit)

Leon is 40 years old, married and works as a manager at a retail store. He currently earns $80,000 per year and has accumulated $75,000 in superannuation savings.

Leon has one superannuation account, his employer's default superannuation fund, and is invested in the fund's default MySuper option. This option provides him with default group insurance cover of $377,500 for Death and $68,000 for TPD. At age 45, Leon becomes paralysed in a car accident and is declared totally and permanently disabled. He makes an insurance claim on his TPD cover and withdraws his superannuation account balance from the fund under a TPD condition of release.

A lump sum benefit of $197,491 is paid to Leon, of which $136,928 is comprised of his superannuation account balance plus investment earnings, and $68,000 relates to his insurance payout. From Leon's perspective, insurance has increased his benefit by 50%, for a relatively modest cost of $7,437, being his default insurance premium over a 5 year period. With these extra funds, Leon can make alterations to his house to help him adjust to his new life and continue to pay his mortgage without having to solely rely on his wife's income.

Additionally, Leon's wife can also continue to work and make an ongoing contribution to society, given Leon is able to afford a carer as a result of his TPD payment, in order to maintain his day-to-day activities whilst his wife is at work.

For Leon's full story, refer to Appendix C.5.

CAMEO: BOB (IP Benefit)

Bob is 45 years old, a public service employee, earning $100,000 per year and has accumulated $175,000 in superannuation with Fund X.

Bob has exercised choice and opened a second superannuation account (Fund Y) into which his future Superannuation Guarantee Contributions (SGC) will be paid. Both superannuation funds offer default insurance cover including IP cover. The cover is set out below:

Fund	Death	TPD	IP per month (benefit period)
X	$325,000	$162,500	$6,250 (5 years)
Y	$104,800	$26,200	$2,500 (2 years)
Total	**$429,800**	**$188,700**	**$8,750**

75% of salary, however, cover is fixed after Bob makes no further contributions to Fund X.

At age 55, Bob has a heart attack and is unable to return to work, so is accepted as a claim by both superannuation funds. His combined claim amount is capped at 75% of his salary at age 55, which is now $123,000.

Bob is paid a monthly benefit from both superannuation funds for the first 2 years and then from superannuation Fund X for the next 3 years. Over a 5 year period, Bob was paid a total of $409,500 in insurance benefits.

Upon reaching 65, Bob's total superannuation balance reaches the amount of $535,102. This compares to $588,843 if Bob had opted out of the insurance cover. Having insurance cover from age 45 to retirement reduced Bob's superannuation account balance at retirement by $53,741 (9%), but in return, Bob has received $409,500 in IP benefits before tax. This payment is sufficient for Bob to continue his mortgage payments of $2,480[1] per month, along with his household expenses over the next 5 years so that when he retires, his house is debt free.

For Bob's full story, refer to Appendix C.2.

As can be seen from the above cameos, the ability for both the superannuation fund member to continue their day-to-day activities as well as the member's spouse to continue their working activities as a result of the insurance benefits provided adds further social and economic benefits to the economy. Whilst these benefits are difficult to quantify in aggregate, they make a significant difference to the members' lives.

- The IP benefits offered under default insurance in superannuation disqualify recipients from being entitled to a full Disability Support Pension (DSP). This is estimated to result in savings in government outlay relating to the DSP worth between $3 billion to $4.2 billion over a period of 10 years.
- It should be noted that the existence of insurance in superannuation, particularly in respect of IP, enables members to access benefits in circumstances where they may have otherwise resorted to government provided benefits. Whilst unquantified, this would be expected to impact on the number of members accessing their superannuation entitlements on alternate conditions of release such as financial hardship.

[1] Based on an average mortgage of $367,700 and an interest rate of 5.25%, May 2017. Mortgage payment of $2,480 per month and a 20 year principal and interest.

- Further, as a result of the active rehabilitation strategies adopted through the use of IP, superannuation members are typically able to be provided a graduated and supported return to work, which provides further, though unquantified benefits, both to the individual and the wider economy by minimising the duration a member receives government income support, while maximising tax receipts from a successful return to paid employment.
- To the extent that default group insurance in superannuation results in additional benefits from superannuation, it also indirectly leads to additional tax revenue for the government, which is estimated to be $3 billion over a period of 10 years. We note, however, that the cost of providing default group insurance in superannuation is considered to be the tax concession given to insurance premiums paid through superannuation. This is estimated to range between $5.25 billion to $6.4 billion over 10 years. Overall, default group insurance in superannuation provides a number of significant qualitative benefits to the community as well as a net savings to government outlay of between $0.65 billion and $1.85 billion over 10 years[2].

The current default group insurance landscape in superannuation

- As at 30 June 2016, there were over 14.9 million MySuper accounts, of which 11.3 million have Death cover (75%), 10.1 million have TPD cover (68%) and 4.2 million have IP cover (28%)[3]. Most of the cover provided as default group insurance in superannuation relates to Death and Lump Sum disability with only 25% of superannuation funds and 28% of accounts maintaining default IP cover.
- There are many people in Australia that have more than one superannuation account. As at June 2016, there were 14.8 million Australians with a superannuation account, and of these 3.8 million people have 2 accounts and 2.7 million people have between 3 and 10 accounts[4].
- Our analysis shows that while 30% of superannuation accounts have an account balance of less than $1,000, only 5% of people have a combined superannuation balance of less than $1,000. This means many of the duplicate accounts have very small balances, albeit some may not have insurance. In addition, most of the duplication of superannuation accounts appears to occur by the age of 35.
- In relation to the current default group insurance product design, there are 2 common types of designs for Death and TPD: life-stage design, where insurance cover is low at younger and older ages and is highest at ages 30 to 45; and a fixed dollar amount of cover which is generally higher for younger ages and tapers down to a lower amount from age 50 onwards.
- Our analysis shows there is significant variation in the nature and level of default group insurance cover offered in superannuation and in the insurance premiums charged by each superannuation fund. The indicative range of default insurance cover and premiums applicable to a member aged 30 is illustrated in Table 2.

[2] Excluding the benefit generated by the members currently on claims.

[3] Source: Annual MySuper Statistics June 2016 (Issued 1 February 2017), Australian Prudential Regulation Authority, Table 6 – MySuper Products.

[4] Australian Taxation Office – Superannuation accounts data overview.

Table 2: Range of default insurance cover and premiums (member aged 30)

Cover type	Average Insurance Amount	Default Insurance Cover		Default Insurance Premium per week	
		Low	High	Low	High
Death	$163,518	$113,092	$401,000	$1.04	$4.28
TPD	$97,477	$50,000	$401,000	$0.50	$8.50
IP (monthly cover)	$779	$850	$2,691	$1.20	$7.75

  - The variation in default premiums reflect the variation in the insurance cover, the gender and occupation mix of members, which in turn influences the risk profile and the number of insurance claims between superannuation funds.
  - Default cover typically varies by age and in a small number of instances, by occupation or gender. Default cover does not generally vary by salary level or account balance.

- Some superannuation funds have introduced cessation rules to stop insurance premiums being deducted once a member's superannuation account balance falls below a specified dollar amount and/or after contributions cease. However, this is not common practice.
- Although the average level of default cover is not excessive, some members are paying for duplicate cover that they are not able to access, specifically in relation to IP.

Results of the modelling of the current state

- It is important to understand the current state and the magnitude and drivers of the issues in order to design the solutions. To this end, a model of the current state of default group insurance in superannuation was built, reflecting the current level and distribution of default group insurance cover, the types of cover, the age, gender, income level, superannuation account balance and as far as practicable, the level of duplication of accounts. This model is calibrated to ATO data, APRA data, a sample ATO file containing 258,000 individual records, and validated at a high level against census data.
- The model was used to project a range of members' salary using both salary scale and wage inflation, their Superannuation Guarantee Contribution (SGC), their insurance premiums and the resulting retirement balances for the different cohorts of members at age 65. SGC is projected at the rate of 9.5% increasing to 12% in 2021, except for three public sector superannuation funds where higher rates were payable, in which case these rates were used.
- This projection shows that if default group insurance premiums continue to be deducted from superannuation members' balances under the current system, default insurance can be expected to reduce members' retirement savings by 6.2% on average by the time they retire at age 65. However, this reduction varies greatly between segments (e.g. low income earners, gender and income), as can be seen in Table 3.

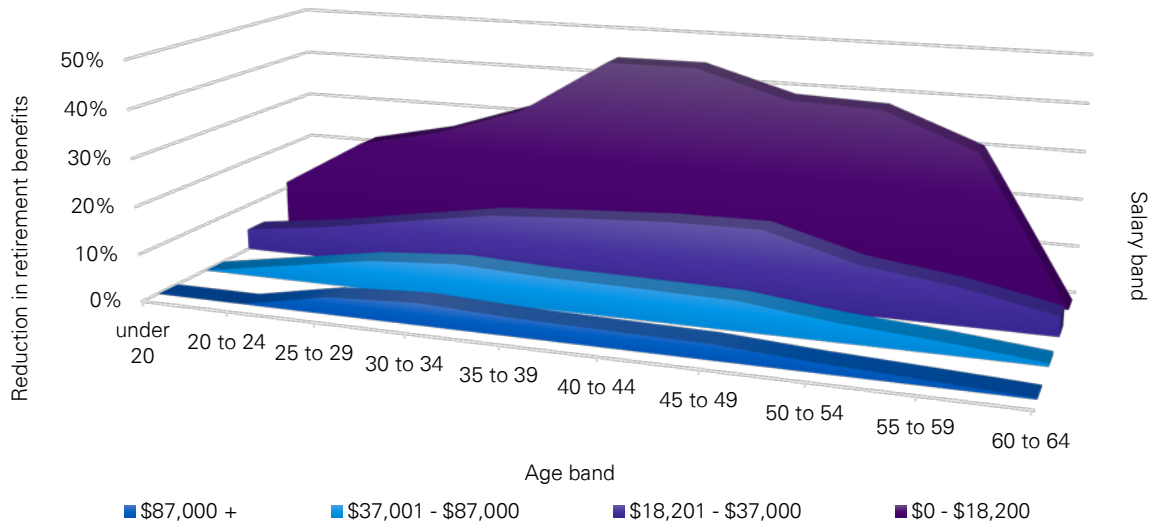
Table 3: Average reduction in retirement savings

Category	Segment	Impact on retirement savings %	Segment	Impact on retirement savings %
Gender	Female	7.6%	Male	5.2%
Age	Under 30	7%	45 to 65	4%
Income	Salary < $18,200	16%	Salary > $87,000	3%

Similarly, the impact of having the average insurance coverage from age 18 to age 65 is estimated as an 11.5% reduction in the retirement savings for a member now aged 18, with a salary of $18,000 initially.

- Low income earners, females and younger members' retirement savings are generally impacted to a greater extent than males, older members and high income earners. Not surprisingly, females and younger members tend to comprise a higher proportion of the low income earners.
- The key finding of this report is that income level has the largest effect on the impact of default insurance on retirement compared to age or gender. For example, the impact on the retirement savings for females aged 35 to 39 earning between $18,200 and $37,000 is 14%, compared to 44% for females of the same age earning less than $18,200. This is illustrated in Figure 1:

Figure 1: Reduction in retirement savings by salary level and age - current state



- The use of a lifecycle or needs-based design of the default cover can significantly mitigate the impact on retirement savings, as illustrated in John's and Lisa's cameos (refer to pages 33 to 35).

Impact of potential changes to the current system

- After public commentary suggesting the merits of certain policy changes, the ISWG requested that KPMG consider the impact of the following potential changes to the default group insurance cover within the Australian superannuation system:

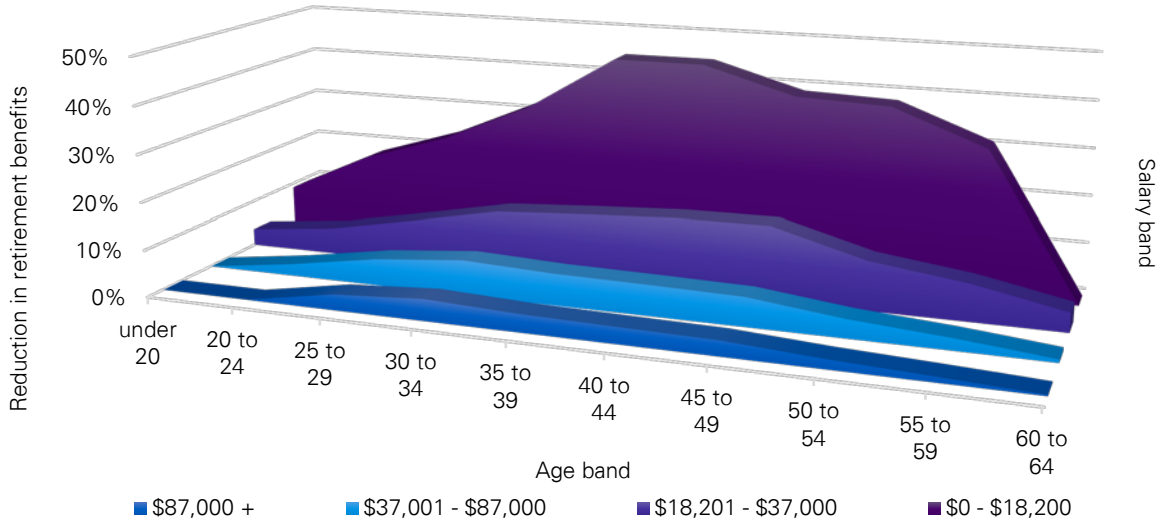
- removing default group insurance cover for younger members (under 30)
- removing duplication of default group insurance cover
- changing the current (opt-out) default group insurance to opt-in insurance cover.

Our modelling of the various scenarios indicated the following:

Removing default insurance cover for younger members (under 30)

- Removing all default group insurance cover for people below age 30 can be expected to reduce the impact on retirement savings from 6.2% to 5.7% on average. The impact by segment is outlined in Figure 2, which shows that, if introduced, this measure is not particularly effective in protecting the retirement savings of those currently most affected, which are low income earners.

Figure 2: Reduction in retirement savings by salary level and age – no cover for under 30



- In aggregate, if all default group insurance cover was removed for members aged 30 or less, default insurance revenue would be 16% lower than the current levels. This is approximately $700 million per annum or 8% of the total group insurance revenue. More importantly, removing cover for members aged under 30 can be expected to increase the premium payable by the remaining members by between 5% and 15%, to compensate for the increase in the average age of the insured lives.

Removing all duplicate insurance

- If all duplicate insurance was removed by removing cover in inactive accounts, this is expected to reduce the overall impact on retirement savings from 6.2% to 6.0%.
- Our analysis suggests that removing duplicate insurance cover from superannuation accounts may not achieve the intended effect. It does not materially improve the retirement savings of low income earners, females or young people. The impact on low income earners remains unchanged; females reduce from 7.6% to 7.4% and young people reduce from 6.9% to 6.8%. Instead these measures can be expected to benefit mostly older age groups and higher income earners.

- When examined by salary level and age group, the most impacted group remains the low income earners, irrespective of age.

Changing default group insurance in superannuation from opt-out to opt-in

- Changing the default group insurance cover within the Australian superannuation industry from opt-out to opt-in would have the most significant impact of the alternative scenarios.
- Based on the experience of superannuation funds that offer voluntary cover, and considering how many Australians need to be convinced to purchase life insurance, it is expected that take up rates would be significantly lower than under an opt-out system, and are estimated to be as low as between 2% and 10%.
- Under this scenario, the level of underinsurance for Death and disability would increase materially, however, based on a conservative assumption of a take up rate of 5% for people under 30, 10% for people aged 30 to 44 and 15% for people aged 45 and over, Death under-insurance would increase from $800 billion to $2.4 trillion and disability under-insurance would increase by 41% from $304 billion to $428 billion. In addition, an estimated 4 million to 5 million people would not be able to access insurance as easily and economically as before, due to occupation, pre-existing conditions or employment status.
- Underwriting may also be necessary, and this would also increase the cost for members, along with the higher cost due to the loading of premiums for occupation, health or employment status.

International perspective

Default group insurance within the Australian superannuation system was compared to insurance offered in pension systems with similarities to Australia. We examined at a high level the pension schemes of seven countries – Canada, Chile, France, New Zealand, Sweden, the United Kingdom and the United States of America (USA).

Our research indicates that Canada and Chile both offer default group insurance in their pension schemes but under a different benefit structure and there is no option to opt-out. In addition, the insurance premium is considered to be additional to the contribution to fund retirement. No other countries provided default group insurance through their pension schemes, with most providing this via retail-style option arrangements.

Possible alternatives

KPMG have also considered a range of possible alternatives in relation to how default group insurance within superannuation could be re-designed. These include:

- Insurance needs can vary for different cohorts within superannuation funds and for individuals over time. For example, younger members are likely to have different insurance needs. Default group insurance settings should, where possible, accommodate the different insurance needs of those cohorts.
- Given that salary is an important driver of benefit erosion, consideration should be given to introducing a premium cap based on SGC, which is in turn linked to salary.

- Introducing appropriate cessation rules can make a significant difference to segments of the membership that require special consideration, such as casual workers and females who are more likely to have interrupted and irregular work patterns.
- Consider the rationale and cost of providing both a lump sum and an income replacement on disablement. Are Death, TPD and IP cover all necessary for default group insurance cover or should funds consider offering TPD and IP interchangeably to best suit their demographic.

In fact, designing default group insurance cover is a balancing act between affordability and the needs of members.

1. Introduction and scope

1.1 Background

Within the Australian superannuation system, it is compulsory for trustees of superannuation funds to offer default Death and TPD insurance to members as part of their default superannuation offering (MySuper). This means that unless members choose to opt-out of the default cover selected by the trustees for them, the default cover would apply automatically and continue until retirement, in most cases. A small number of superannuation funds also offer default IP[5] insurance, although this is not a legislated requirement. For the purpose of this report, all three insurance benefits (Death, TPD and IP) are considered, as long as the cover is offered on an opt-out basis.

A description of the insurance benefits is provided below.

- Death Insurance: A lump sum benefit paid to the beneficiary(s) when the insured life dies.
- TPD Insurance: A lump sum benefit paid when the insured life is considered to be disabled to such an extent that they are incapable of ever returning to work. Some superannuation funds pay the benefit in instalments while the individual remains disabled (for example over a 5 year period).
- Long-term IP Insurance: An income replacement benefit paid on a monthly basis where the insured life is considered to be temporarily incapable of working. Benefits are generally paid to at least age 65 or until the member is capable of returning to work.
- Short-term IP Insurance: As per Long-term IP, but income payments are only made for a short period (typically 2 years).

Default group insurance is offered by industry, retail, public sector and corporate superannuation funds to members on an opt-out basis.

1.1.1 Key issues

The inclusion of default group insurance in superannuation is quite unique to Australia when compared to other pension systems around the world. Over the last 5 years, default group insurance in superannuation has come under some scrutiny by the community as a result of:

- changes in the group insurance market, including a spike in TPD claims, which led to large insurance premium increases in 2013
- significant media coverage regarding the payment of insurance claims and policy terms and conditions, which restricted the payment of benefits

[5] Also referred to as Group Salary Continuance (GSC) insurance.

- the requirement for trustees of superannuation funds to review the design of insurance benefits, partly because of the introduction of the APRA Superannuation Prudential Standard SPS 250 Insurance in Superannuation (SPS 250) from 1 July 2013, and the large increases in the cost of insurance.

As a result of the above, the design of default group insurance within superannuation is being questioned and alternative models are being proposed to potentially offer better solutions. At the heart of the debate are three key issues:

Multiple accounts

Erosion of retirement savings

Appropriate design

Many members have multiple superannuation accounts and therefore, members are likely to have multiple levels of insurance cover within each of these accounts. Other cohorts of members may not have an appropriate level of cover given their age or other circumstances.

This in turn means that members' retirement savings could be un-necessarily eroded because too much insurance cover may be provided to them relative to what they wish to have, need or can afford.

The superannuation and insurance industries have recognised that these concerns needed to be addressed and formed a working group, the ISWG, which is made up of five associations, including Industry Super Australia (ISA), The Association of Superannuation Funds of Australia (ASFA), Industry Funds Forum (IFF), the Australian Institute of Superannuation Trustees (AIST), and the Financial Services Council (FSC), two insurers (MetLife and AIA), two superannuation funds (AustralianSuper and BT) and one consumer representative (CHOICE).

The working group has requested that KPMG provide assistance to the ISWG as described below.

1.2 Scope

The ISWG engaged KPMG to provide advisory services to the ISWG by conducting research and modelling relating to the social and economic benefits of default group insurance in superannuation to the community.

The purpose of the engagement was to assist the ISWG by:

- examining the social economic benefits and the costs of the current system of having default group insurance within superannuation on an opt-out basis
- developing a model which will enable the examination of the costs and benefits to members and the community over the medium and long term
- recommending whether the current system should remain; or alternatively

- considering if certain aspects of the current system could be modified to address the concerns being raised.

In approaching this analysis, we have considered the following modifications to the superannuation system, which are being discussed by commentators and others:

- lowering or removing the levels of default group insurance for younger members who may have less need for insurance
- reducing or removing duplicate insurance accounts
- changing from the current opt-out system to an opt-in system.

The remainder of this report outlines our analysis and findings.

2. Costs and benefits of default insurance in superannuation

2.1 Insurance is a key risk management strategy for individuals and the Australian society as a whole

Before we examine the merits of having default group insurance in superannuation, let's discuss the merits of having insurance in the first place. Why have insurance?

In modern society, insurance is considered a key risk management strategy.

Through insurance, an individual can transfer the consequences of an unlikely, but possible future event, such as premature death or disability, to a larger pool that is more able to withstand the consequences. If a member, or their financial dependants in the case of death, find themselves in this situation without insurance, they will need to rely on savings, financial support from friends or family, and/or government assistance.

An individual who buys life insurance is paying a small fixed cost to the insurer, so that he or she can gain more certainty and financial security for his / her dependents. In the same way that travel insurance helps an individual take a holiday without having to worry about flight cancellations or large medical bills overseas if they have an accident, life insurance allows individuals to have peace of mind knowing that their dependants can be looked after should something unexpected happen to their health.

Without insurance, each person can take less risk individually, which means collectively, the community would have less certainty and hence, becomes higher risk overall. The ability to take risk and be enterprising is a distinct feature of modern human society and allows us to make significantly more progress. This report's key underlying presumption is that having adequate insurance is a positive step for the individual and the Australian community more broadly.

2.2 Default Insurance in superannuation accounts makes it easier and more economical for Australians

For most individuals, default group insurance in superannuation is a more cost effective and convenient way to purchase insurance than doing so privately. This is because:

- Insurance premiums are deducted from compulsory superannuation contributions, without the need to apply for cover. Automatic acceptance limits mean that insurance is automatically provided to a member, generally upon starting employment.

- Death and TPD insurance premiums for default cover are effectively paid from pre-tax salary, making Death and TPD premiums more affordable than purchasing this cover outside of superannuation[6], which must be funded from after-tax money. IP premiums are tax deductible inside or outside superannuation, therefore, the main financial advantage is the lower cost of IP through superannuation, due to this being provided within a group environment. We note, however, that many people would not have purchased insurance if it was not provided through default arrangements. Conversations with insurers and funds suggest that, although people recognise the need to have insurance, without prompting, they rarely take the positive step of initiating the purchase.
- Group insurance premiums are typically lower than retail insurance premiums. This is because group insurance typically has lower overheads, resulting from an absence of underwriting costs and commission payments.

APRA data[7] shows that for group insurance premiums, 80% of the premium is paid back to members in claims, 12% is spent on expenses and commission, with the remainder constituting profit. This compares with retail insurance premiums, where 50% of the premium is spent on claims, 40% on expenses and commission, with the remainder constituting profit.

For some members, particularly those with poorer health than the average person or with high risk occupations, insurance cover can be obtained through superannuation under default group insurance within automatic acceptance limits, with no underwriting and at lower prices than could be obtained through retail insurance.

In addition, default group insurance allows some members to access insurance when they would not be able to otherwise. Whilst in some cases, exclusions for pre-existing conditions may apply, the fact that cover is provided remains a key benefit.

It should be noted that the existence of insurance in superannuation, particularly in respect of IP, enables members to access benefits in circumstances where they may have otherwise resorted to government provided benefits. Whilst unquantified, this would be expected to impact on the number of members accessing their superannuation entitlements on alternate conditions of release such as financial hardship.

Further, as a result of the active rehabilitation strategies adopted through the use of IP, superannuation members are typically able to be provided a graduated and supported return to work, which provides further, though unquantified benefits, both to the individual and the wider economy by minimising the duration a member receives government income support, while maximising tax receipts from a successful return to paid employment.

2.3 Default insurance in superannuation accounts for much of recent growth in insurance coverage

Group insurance in superannuation has grown at a higher rate compared to the life insurance risk market overall over the last 15 years: 16% p.a. vs 12% p.a. between 2003 and 2012 and 12% pa vs 7% p.a. between 2013 and 2016. This is highlighted in Table 4 below.

[6] Death and TPD benefits are taxable in some circumstances, for example if not paid to dependents.

[7] APRA – Quarterly Life Insurance Performance database – December 2016 (issued 14 February 2017).

Table 4: Growth rate in insurance coverage

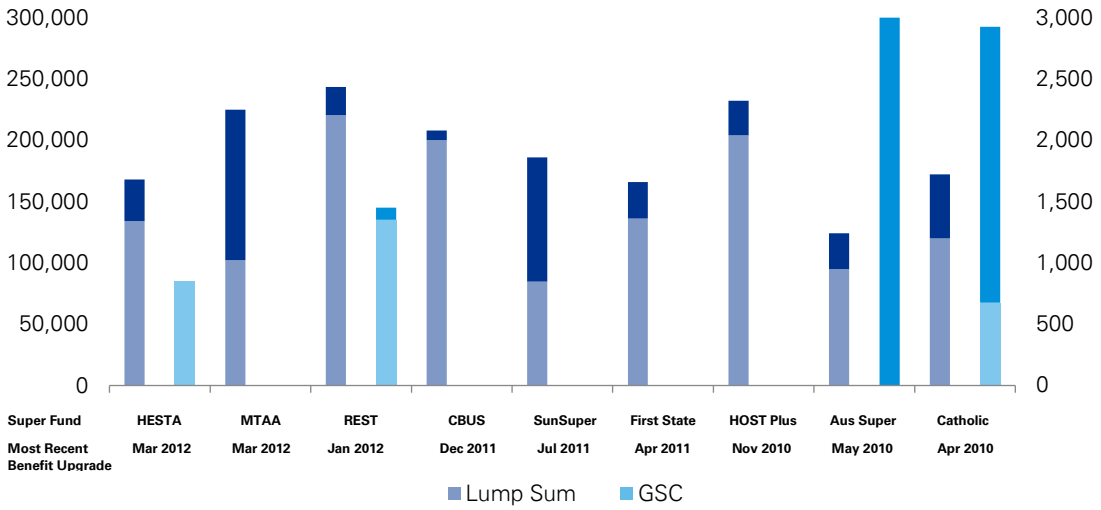
	Average growth rate[8] 10 years to 2012	Average growth rates 2013 to 2016
Group insurance (superannuation)	16%	12%
Total risk	12%	7%

Even if the majority of the premium growth since 2013 can be attributed to increases in premium rates as the insurers (and reinsurers) sought to restore profitability, the growth rate of insurance in superannuation prior to 2013 is clearly higher than the rest of the risk market. A large part of this growth rate prior to 2013 is due to default group insurance in superannuation and the increase in levels of cover during this time.

As an example, in 1985, CBUS was the largest group insurance fund in Australia, covering only the construction industry. At that time, the default level of Death cover for a male aged 30 was $17,500. Today, CBUS's default level of Death cover for a 30-year old male is $208,000.

Since then, almost every superannuation fund offers default Death cover, many with more substantial amounts as illustrated in Figure 3. The darker blue part of each column represents the increases in cover that were introduced between 2010 and 2012 by each of the superannuation funds. These nine industry funds represent approximately 50% of the industry funds default cover at the time.

Figure 3: Change in Default Cover ('000) – Male age 40 Blue Collar



2.4 Group insurance in superannuation provide significant benefits to members

APRA collects statistics on the insurance premiums paid by superannuation funds and the claims paid out of superannuation funds every year. In the 3 year period to June 2016, APRA statistics show that over 200,000 claims were made from insurance in superannuation, valued

[8] APRA – Quarterly Life Insurance Performance – December 2016 (issued 14 February 2017) and KPMG analysis.

at $13.8 billion[9], representing 0.8% of Australia's Gross Domestic Product. This is in addition to reserves held by insurers for claims reported but not admitted or IP claims in the course of payment.

Table 5: Number and value of insurance claims admitted and paid from superannuation (July 2013 - June 2016) [10]

Cover type	Number of claims paid	Amount of claims paid ($' million)	Average Benefit per claims
Death	53,298	6,644	124,657
TPD	48,937	5,045	103,092
IP	102,538	2,092	20,402
Total	**204,773**	**13,781**	

The average Death benefit over this period was $124,657 per claim, the average TPD benefit was $103,092 per claim, and the average IP claim was $20,402 per claim. These are significant levels of benefits to members who are disabled and dependants (in respect to a member's death) and can provide meaningful financial relief to individuals and their families. For example, given the average level of mortgage repayments in Australia[11], the average Death benefit is equivalent to more than 4 years' of mortgage repayments for the surviving family.

Approximately 50% of the insurance benefits referred to in Table 5 above relate to default group insurance in superannuation.

We note, superannuation law permits members to receive IP benefits in circumstances where they would otherwise be ineligible to qualify for TPD. The temporary incapacity condition of release allows eligibility when members are either incapable or partially incapable for their own duties. By contrast, TPD requires, as a minimum standard, that members are unlikely to perform their role or any role for which they are reasonably qualified by education, training or experience. For this reason, members with IP cover are able to more readily access benefits than would otherwise be the case.

2.5 Greater coverage reduces the issues of underinsurance

KPMG's previous reports on underinsurance[12] have estimated the level of underinsurance within Australia to be $304 billion per annum in disability cover, and the level of underinsurance on the lives of employed people against premature death in Australian families is estimated to be $800 billion.

[9] Source: Annual Superannuation Bulletin June 2016 (Issued 1 February 2017), Australian Prudential Regulation Authority, Table 14c - Insurance claims by insurance type and fund type - trend (excluding SMSFs).

[10] Source: Annual Superannuation Bulletin June 2016 (Issued 1 February 2017), Australian Prudential Regulation Authority, Table 14c - Insurance claims by insurance type and fund type - trend (excluding SMSFs).

[11] Based on an average mortgage of $367,700 and an interest rate of 5.25%, May 2017. Mortgage payment of $2,480 per month and a 20 year principle and interest.

[12] KPMG report - Death and TPD underinsurance 2013, Disability Income underinsurance 2013.

Default group insurance in superannuation has materially helped to reduce the underinsurance gap to these levels, with a significant proportion of Australia's life insurance provided through superannuation funds. Having default opt-out cover means that substantially more people have insurance cover than would otherwise be the case.

Having said this, care must be taken to avoid complacency towards the issue of underinsurance as awareness of default group insurance cover grows. A member may feel their insurance needs have been met as they have default group life insurance through their superannuation. However, the variations in insurance offerings between superannuation funds, particularly in the case of TPD and IP, could result in members believing they are appropriately covered, when in reality they are underinsured. This is covered in more detail in section 3.

2.6 Greater adequacy of benefits when compared to the government safety net

The government provides a number of benefits to individuals or their dependents on sickness, Death or disability, including:

- Bereavement allowance
- Disability Support Pension
- Sickness allowance
- Mobility allowance
- Crisis payment
- Carer payment, allowance and supplement
- Special benefit
- Widow allowance
- Pharmaceutical, telephone, and utilities allowances.

For the majority of Australians, government social security benefits are not an adequate substitute for insurance. The typical benefit is around $500 to $800 per fortnight for a single person and lower per person for a couple. For the majority of members who become disabled, or the families of members who die, this amount is generally insufficient to maintain their current lifestyle. The provision of default group insurance in superannuation provides a greater adequacy of benefits for members who become disabled or for the families of members who die.

The cohort of members who may not benefit from greater adequacy of benefits through default group insurance are low income earners (earning below $37,000 p.a.), without savings or assets. These include part-time workers, or people on low salaries. For these individuals, unless they opt-out of default group insurance, they will be paying premiums towards insurance for benefits which are similar to the government benefits they would have received if they didn't have insurance. In addition, they may miss out on other benefits of being on a DSP or other social benefits, for example lower travel, healthcare and Pharmaceutical Benefit Scheme costs.

An example of the benefit of default group insurance cover can be illustrated in the below cameo.

CAMEO: LEON
Leon is 40 years old, married and works as a manager at a retail store. He currently earns $80,000 per year and has accumulated $75,000 in superannuation savings. Leon has one superannuation account, his employer's default superannuation fund, and is invested in the fund's default MySuper option. This option provides him with default group insurance cover of $377,500 for Death and $68,000 for TPD. At age 45, Leon becomes paralysed in a car accident and is declared totally and permanently disabled. He makes an insurance claim on his TPD cover and withdraws his superannuation account balance from the fund under a TPD condition of release. A lump sum benefit of $197,491 is paid to Leon, of which $136,928 is comprised of his superannuation account balance plus investment earnings, and $68,000 relates to his insurance payout. From Leon's perspective, insurance has increased his benefit by 50%, for a relatively modest cost of $7,437, being his default insurance premium over a 5 year period. With these extra funds, Leon can make alterations to his house to help him adjust to his new life and continue to pay his mortgage without having to solely rely on his wife's income. Additionally, Leon's wife can also continue to work and make an ongoing contribution to society, given Leon is able to afford a carer as a result of his TPD payment, in order to maintain his day-to-day activities whilst his wife is at work. Note: The premium also covers Leon for premature death as well as disability. For Leon's full story, refer to Appendix C.5.

2.6.1 Savings in government social security costs

For most individuals, TPD / disability insurance cover will reduce the need for the individual to access government social security benefits such as the DSP. As the DSP is means tested, it is reasonable to expect that increasing the number of people who have a more adequate level of disability insurance will reduce the burden of the DSP on the government.

In assessing the extent to which the inclusion of default group insurance in superannuation has resulted in savings in social security costs, the following observations are made:

- The Australian government provides social security benefits in the form of a basic income level, subject to an assets test and an income test. The key long term sickness benefit is an income benefit, the DSP. Other income benefits are shorter term, for example, the Sickness Allowance, while a number of other social security benefits relate to events not covered by insurance in superannuation, such as carer payments, crisis payments, widow's allowance, Newstart, Job start Australia, etc.

By contrast, the cover provided by default group insurance in superannuation is mostly lump sum benefits (Death and TPD). The lump sum benefit from default group insurance in superannuation is generally not sufficiently high to disqualify a person from government benefits from an assets test perspective. Further, the lump sum can be used by the individual for a range of purposes, such as to pay off their mortgage, which means it may not impact their level of future income, and therefore may have no impact on the income test.

In our view, while the lump sum insurance payment will benefit the recipients greatly, it is difficult to demonstrate a direct link between the payment of a lump sum benefit from

insurance in superannuation and a reduction in access to government social security benefits. However, the link to reduced access to the DSP from an IP benefit is clearer.

It should be noted that in respect of IP benefits, insurers and superannuation funds seek to provide targeted rehabilitation services which offer significant benefits to all members including those on lower incomes who are provided with cover of this nature.

Based on the current income test for the DSP and the current level of IP default cover offered by the major superannuation funds in our sample, the level of IP benefits will disqualify the recipient from a full DSP, however, some people would still qualify for a partial DSP, provided that their level of disability is considered to be sufficiently severe[13], and their spouse's income is sufficiently low.

Allowing for these factors, the current assets test, the distribution of wealth in Australia[14], the incidence of new claims indicated by APRA statistics and the range of IP benefit periods offered in default group superannuation[15], it is estimated that the saving in the DSP is 37.5 cents for every dollar of IP benefits paid to people who would otherwise qualify for the full DSP and pass the income and assets tests.

Over a period of 10 years, the savings to the DSP from future default IP claims is estimated to be in the range of $3.0 billion to $4.2 billion, depending on the proportion of IP claims that result from default group insurance, and the proportion of people who would qualify for both IP benefits and the DSP. This is before allowing for the savings resulting from the significant number of people who have already received IP benefits to date. Over the last 3 years, APRA data suggests that there have been 102,538 people who have received IP benefits from superannuation.[16]

We note that, though not easily quantifiable (and not included in the above revenue numbers) there would exist further benefits to the economy from members or their families receiving lump sum benefits for Death or TPD. This could include reduced eligibility for means tested government benefits in some cases or further expenditure and tax receipts generated via increased disposable income within the supported families than would otherwise be the case.

Although a material reduction in social security benefits can be expected, we believe that the reduction in government social security costs is a secondary benefit of default group insurance in superannuation. The primary benefit is to enable members to better take care of themselves and their family, should they die prematurely or become disabled. For example, for a family, an adequate level of insurance covers the family's needs, including rent or mortgage payments until the children are adults. A Death benefit of $234,811 at age 40 can meet the repayment for an average mortgage of $367,700 for a period of 7 years[17], offering the surviving family the financial means to remain in the current family home for a substantial period of time until the surviving partner can adjust and return to work. A TPD benefit of $145,908 can allow a disabled person to alter their home to adjust to their new medical condition, while at the same time, pay living expenses and enable the family to readjust to

[13] The DSP requires the recipient to not be able to work for any more than 15 hours a week.

[14] ABS Household wealth and Wealth distribution Australia 2011-2012.

[15] 2 years to age 67.

[16] Refer Table 4 source; APRA Superannuation Bulletin of this report.

[17] KPMG analysis based on an average mortgage of $367,700 and an interest rate of 5.25%, May 2017. Mortgage payment of $2,480 per month and a 20 year principle and interest.

having one income rather than two incomes. While these levels of benefits are not yet at the "adequate" level, these payments can go a long way towards helping members and their families to maintain their dignity, regroup and adjust to their new circumstances.

2.7 Increased tax revenue from tax on insurance benefits

The calculation of tax on superannuation benefits is complex[18]. The tax payable depends on both the form of the payment, the age of the deceased and the recipient of the payment, as well as the tax components that form the benefit.

Insurance benefits paid out of superannuation funds are taxed in the hands of the recipients.

The Death benefit paid to a dependant beneficiary under tax law will generally be paid free of tax. If paid to a non-dependant, the tax–exempt component will be tax free, while the taxed element and untaxed element are taxed at the rates of 15% and 30% respectively.

In respect of TPD, the insured amount is paid into the superannuation fund when the claim is successful, and on payment to members, is taxed in the same manner as other superannuation benefits, with the tax-free component based on the proportion of days to retirement.

IP payments as the result of a claim will be taxed as assessable income in the hands of the recipient.

If we accept that many members who have default group insurance in superannuation would not otherwise have insurance cover (as they would not take the initiative to purchase cover themselves), then the extra tax revenue from the benefits payable to these members is an additional source of revenue to the government that would not be available if default group insurance did not exist. This is a benefit in addition to the savings in social security benefits discussed previously.

The additional revenue due to tax on default group insurance benefits can be estimated as approximately $288 million a year or $2.9 billion over 10 years, if we assume that 90% of default cover would not be taken up voluntarily. This is based on an average tax rate on benefits of 9% and estimated claims paid from default group insurance in superannuation of $3.5 billion a year.

2.8 Tax concessions for insurance in superannuation

Under the current superannuation rules, the majority of insurance premiums paid through a superannuation fund attract tax concessions at 15%. If these policies were bought outside of superannuation, only IP would be tax deductible, whilst Death and TPD premiums would not. Therefore, the cost to the government's revenue can be considered to be the tax concession given to Death and TPD premiums taken out as part of default group insurance in superannuation, which has been estimated as $525 million per annum, or $5.25 billion over 10 years, if we assume that:

- the total insurance in superannuation premium is $8.7 billion

[18] https://www.ato.gov.au/Super/APRA-regulated-funds/Paying-benefits/Calculating-components-of-a-super-benefit/

- 51% of insurance within superannuation is default group insurance
- a concessional tax rate of 15% continues to apply
- the proportion of the premium which relates to Death and TPD is 80%.

If one considers that many of the members with default IP cover in superannuation would not have purchased this cover if it was not offered to them as default insurance, then a proportion of the tax concession given to IP premiums may also be considered as part of the "cost" of default group insurance in superannuation. If this proportion is assumed to be 90%, the tax concession given to default group insurance in superannuation is estimated to be $640 million pa or $6.4 billion over 10 years.

The estimate of the tax concession given to default group insurance is in the range of $5.25 billion to $6.4 billion over 10 years.

2.9 Summary of findings

Overall, the cost/benefit analysis of default group insurance in superannuation can be summarised as follows.

There are many qualitative benefits to having default group insurance in superannuation, such as:

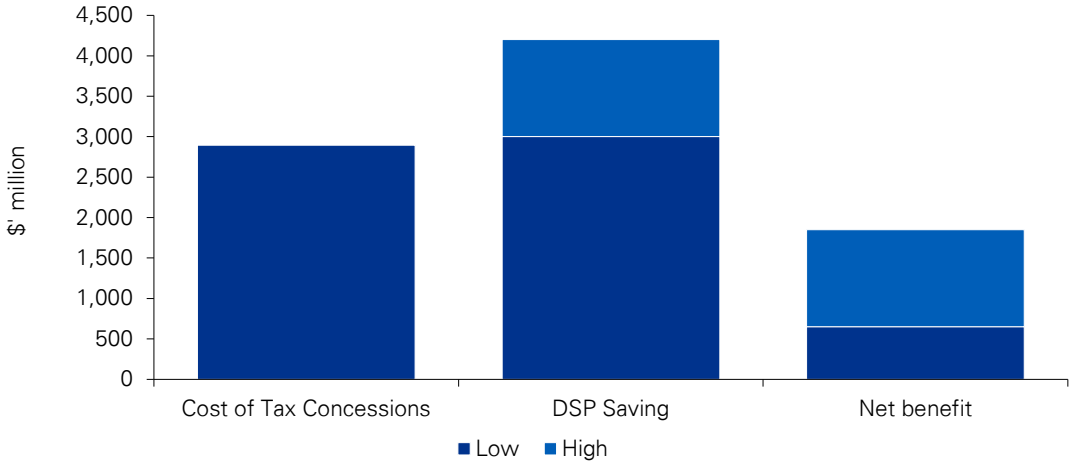
- greater insurance coverage for the population, thus helping to reduce the underinsurance challenge in Australia
- improved access to insurance, due to lower cost and minimal need for underwriting in comparison to insurance held outside of superannuation
- greater adequacy of benefits compared to the government safety net social security benefits, thus allowing people to take better care of their family and dependants in the event of Death or disability
- it should be noted that the existence of insurance in superannuation particularly in respect of income protection enables members to access benefits in circumstances where they may have otherwise resorted to government provided benefits.

In addition to the qualitative benefits, default group insurance in superannuation also offers a number of quantitative benefits including:

- savings in government outlays relating to the DSP of at least $3 billion to $4.2 billion over a period of 10 years and additional tax revenue of $2.9 billion over a period of 10 years, due to the tax payable on insurance benefits
- these benefits are somewhat offset by tax concessions provided to default group insurance premiums in superannuation, which is estimated to be in the range of $5.25 billion and $6.4 billion over 10 years.

We therefore conclude that default group insurance in superannuation provides a number of significant qualitative benefits to the community as well as quantitative net benefits[19] to government outlays of between $0.65 billion and $1.85 billion over 10 years.

Figure 4: Costs and benefits of default group insurance over 10 years



[19] Excluding the benefits to the government relating to people who are currently on claim.

3. Current state

A key part of our scope is to consider the impact on the costs and benefits should certain measures be introduced to address the concerns being raised in relation to default group insurance in superannuation. Before embarking on the modelling, it is always instructive to understand the relevant key facts about default group insurance in superannuation today, including:

- the level of benefits provided by default group insurance in superannuation
- the number of MySuper accounts with default group insurance
- the insurance product design
- the range of default group insurance cover offered in superannuation
- the characteristics of duplicate insurance in superannuation.

3.1 Default insurance is held by most MySuper account holders

As at 30 June 2016, there were over 14.9 million MySuper accounts, of which, 11.3 million had Death cover, 10.1 million had TPD cover and 4.2 million had IP cover[20]. This compares well with 15.9 million Australians within the working age population aged 15 to 64 at the same date.

Table 6 provides a breakdown of the number of MySuper accounts with insurance across the different types of superannuation funds: industry, retail, public sector and corporate.

Table 6: Number of MySuper accounts with insurance

Type	Number of MySuper Accounts	Number (and Proportion) of MySuper Accounts with Insurance					
		Life	%	TPD	%	IP	%
Industry	9,753,894	7,421,438	76%	6,372,421	65%	2,980,865	31%
Retail	3,289,052	2,447,383	74%	2,300,360	70%	641,094	19%
Public Sector	1,652,170	1,252,801	76%	1,276,167	77%	539,546	33%
Corporate	216,279	184,508	85%	173,794	80%	46,643	22%
Total	**14,911,395**	**11,306,130**	**76%**	**10,122,742**	**68%**	**4,208,148**	**28%**

Source: APRA MySuper Statistics June 2016

[20] Source: Annual MySuper Statistics June 2016 (Issued 1 February 2017), Australian Prudential Regulation Authority, Table 6 – MySuper Products.

The following observation can be made based on the information in Table 6:

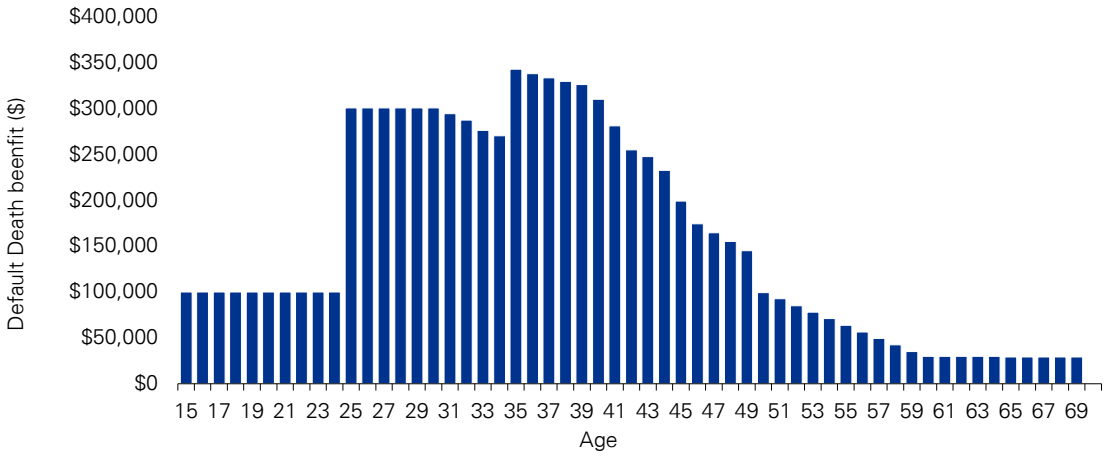
- Industry fund and public sector MySuper accounts make up 76% of all MySuper accounts. Retail and corporate superannuation funds make up 24% of all MySuper accounts. A relatively low proportion of MySuper accounts have IP insurance, this is the case for all superannuation funds types, with about one third of industry funds and public sector funds maintaining default IP insurance, whilst approximately one fifth of retail fund and corporate fund MySuper accounts have default IP insurance.

3.2 Insurance product design

Typically there are two common types of default group insurance cover design for Death and TPD within superannuation. These include:

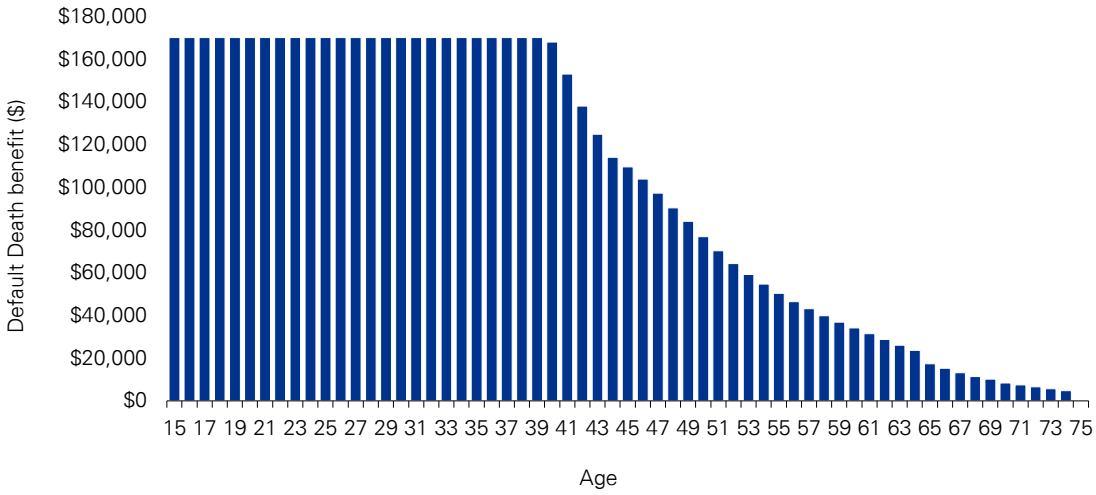
- Life-stage design, where insurance cover is low at younger and older ages and is highest at ages 35 to 40 as illustrated in Figure 5 below.

Figure 5: Life-stage default insurance design



- A fixed dollar amount of cover which tapers down to a lower amount at older ages. An example is provided in Figure 6 below, which shows a tapering down of cover from age 40.

Figure 6: Fixed dollar amount default design



The introduction of Stronger Superannuation and the requirements of APRA's SPS 250 was a trigger for trustees of superannuation funds to consider both the affordability of insurance cover and the need to tailor insurance benefits to members' needs. As a result, a number of trustees have recently introduced measures to safeguard against excessive account erosion due to the deduction of insurance premiums. For example, the published PDS of a number of major superannuation funds include cessation rules that stop insurance premium deductions 12 months after contributions cease and/or once a member's superannuation account balance falls below a specified dollar amount. We note, of the 12 superannuation funds that were analysed (refer to Section 4.1 for more detail), the cessation dollar amount ranged between $1,200 and $10,000.

3.3 Range of default group insurance cover

The level of default group insurance cover offered in the Australian superannuation industry varies significantly by superannuation fund. Similarly, the amount of premium deducted from members' accounts by each superannuation fund with respect to Death, TPD and IP cover also varies substantially. This variation is examined in more detail in this section.

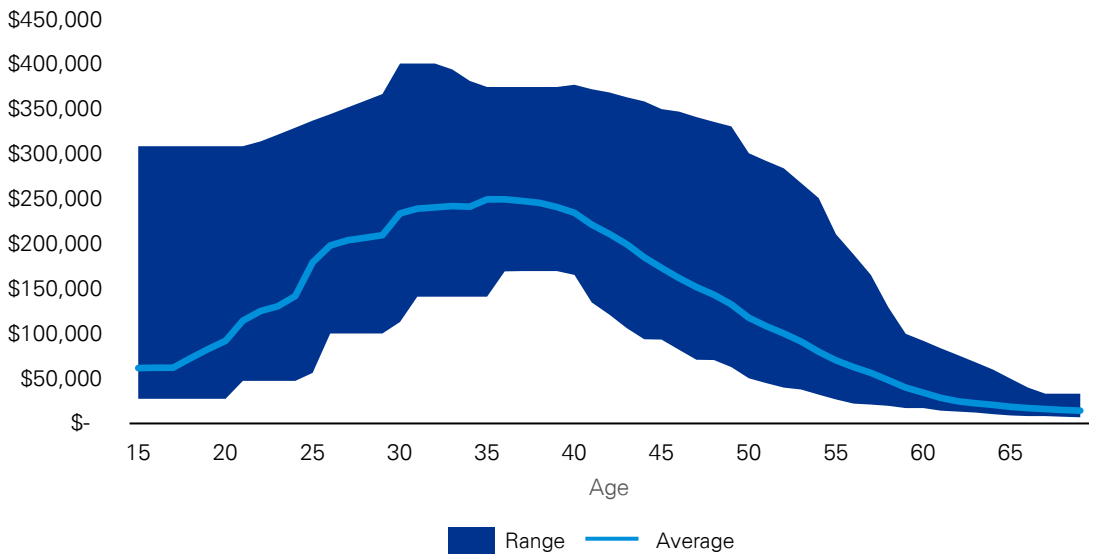
3.3.1 Death insurance

The shaded area in Figure 7 shows the highest and lowest levels of cover offered by the funds examined (refer to Section 4.1 for more detail), and the light blue line denotes the average level of cover.

The average Death cover varies by age as illustrated in Figure 7 and is in fact moderate at younger and older ages. For example, the average default cover is $92,218 for a 20 year old member and reduces to $18,500 at age 65.

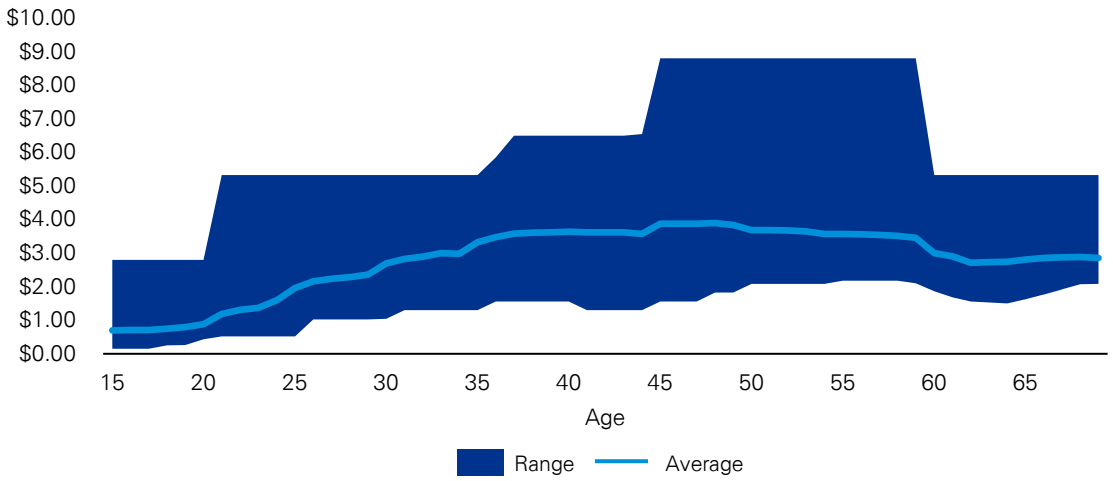
However, the range of cover differs considerably between funds, for example, at age 30, the default Death cover can vary between $113,000 and $401,000, depending on the superannuation fund to which a member belongs.

Figure 7: Average Death default cover



Consistent with the range of default cover, there is a range of premiums being charged for Death cover (see Figure 8). For example, Death insurance premiums for a male aged 30 can vary from $1.04 per week to $4.28 per week depending on the superannuation fund to which they belong. Most of the variation is likely to be the result of the different levels of cover, age distribution, occupation and gender mix of the superannuation fund.

Figure 8: Average Death premium per week (for default cover)

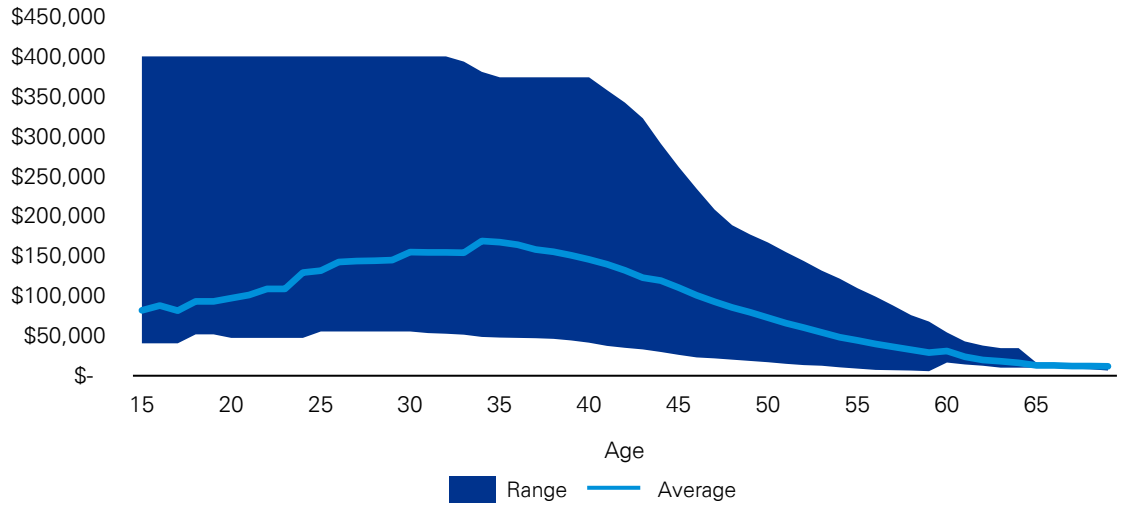


3.3.2 TPD insurance

There is a higher level of variation between superannuation funds for TPD compared to default Death insurance. For example depending on the superannuation fund to which a member belongs:

- for ages 15 to 17, default TPD cover can vary between $40,500 to $401,000 (a factor of 10 between the highest and lowest cover)
- for age 30, default TPD cover can vary between $50,000 and $401,000 (a factor of 8 between the highest and lowest cover); and
- on average, TPD cover increases to reach a maximum of $169,236 at age 34 and reduces over the lifetime of a member to $12,824 at age 65, as displayed in Figure 9.

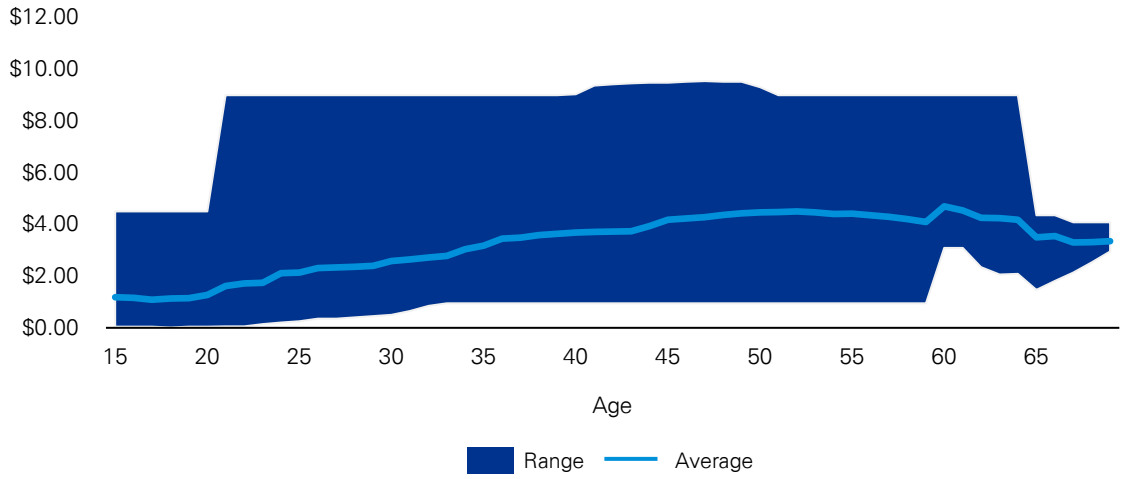
Figure 9: Average TPD default cover



As can be seen in Figure 10 below, default TPD premiums vary significantly, ranging from a minimum of $1.15 per week to a maximum of $4.54 per week. For example, at age 30, depending on the fund to which a member belongs, default TPD premiums can vary between $0.50 and $8.50 per week and are, on average, $2.58 per week.

Similar to the Death insurance premium range, some of the variation in the TPD insurance premiums is due to the different TPD terms and conditions, the level of cover and in some funds, occupation and gender mixes.

Figure 10: Average TPD premium per week (for default cover)

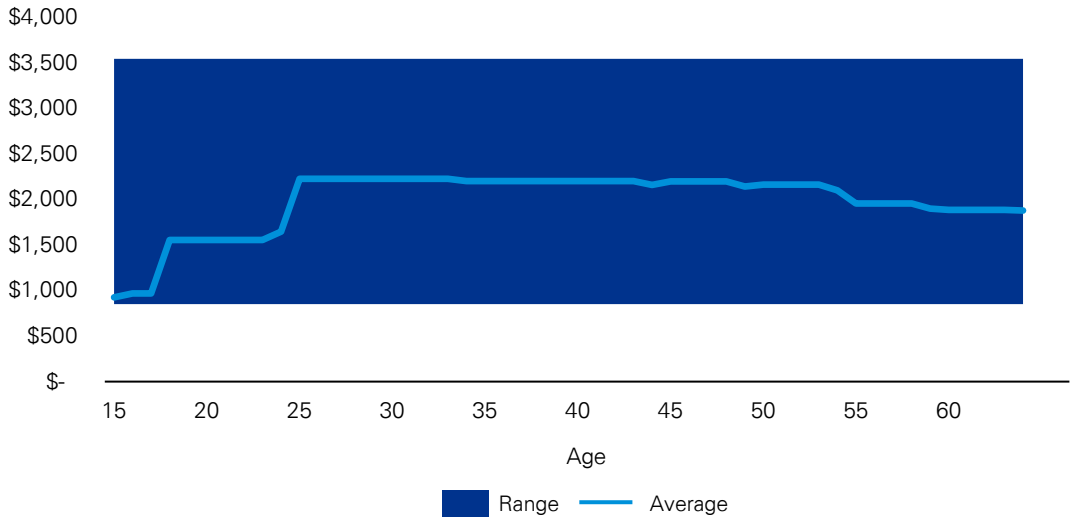


3.3.3 IP insurance

IP Cover is not mandatory under MySuper and is provided on a default basis by half of the 12 superannuation funds analysed (refer to Section 4.1 for more detail) in this report. Of this cover, 67% offer a fixed amount of cover (e.g. $2,500 per month) while 33% offer salary linked cover (e.g. 75% of monthly salary).

Default cover ranges from $850 per month to 90.4% of salary[21] combined with a range of benefit periods, from 2 year to age 67.

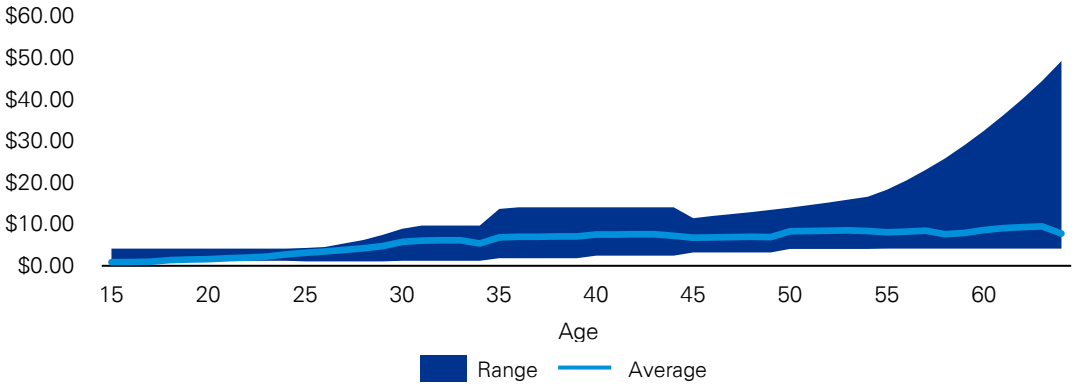
Figure 11: Average IP Monthly Benefit



[21] The graph assumes an annual salary of $47,000 to convert salary related cover to a dollar amount.

IP premiums can vary significantly for members who are close to retirement (Figure 12). The average IP premium for a 64 year old is $7.75 per week for the default cover, however, this premium can increase to almost $50 per week depending on the amount of the cover, and the benefit period and waiting period. For example, not surprisingly, the premium for IP cover with a waiting period of 30 days and a benefit period to age 67 is much higher than the premium for IP cover with a waiting period of 90 days and a waiting period of 2 years.

Figure 12: Average IP premium per week (for default cover)



The below cameo highlights the benefit of default IP cover for a member who becomes disabled and receives an insurance payment from their superannuation fund.

CAMEO: BOB

Bob is 45 years old, a public service employee, earning $100,000 per year and has accumulated $175,000 in superannuation with Fund X.

Bob has exercised choice and opened a second superannuation account (Fund Y) into which his future SGC will be paid. Both superannuation funds offer default insurance cover including IP cover. The cover is set out below:

Fund	Death	TPD	IP per month (benefit period)
X	$325,000	$162,500	$6,250 (5 years)
Y	$104,800	$26,200	$2,500 (2 years)
Total	**$429,800**	**$188,700**	**$8,750**

75% of salary, however, cover is fixed after Bob makes no further contributions to Fund X.

At age 55, Bob has a heart attack and is unable to return to work, so is accepted as a claim by both superannuation funds. His combined claim amount is capped at 75% of his salary at age 55, which is now $123,000.

Bob is paid a monthly benefit from both superannuation funds for the first 2 years and then from superannuation Fund X for the next 3 years. Over a 5 year period, Bob was paid a total of $409,500 in insurance benefits.

Upon reaching 65, Bob's total superannuation balance reaches the amount of $535,102. This compares to $588,843 if Bob had opted out of the insurance cover. Having insurance cover from age 45 to retirement reduced Bob's superannuation account balance at retirement by $53,741 (9%), but in return, Bob has received $409,500 in IP benefits before tax. This payment is sufficient for Bob to continue his mortgage payments of $2,480[22] per month, along with his household expenses over the next 5 years so that when he retires, his house is debt free.

For Bob's full story, refer to Appendix C.2.

[22] Based on an average mortgage of $367,700 and an interest rate of 5.25%, May 2017. Mortgage payment of $2,480 per month and a 20 year principal and interest.

3.4 Impact of premium rate structure on erosion of benefits

Default group insurance in superannuation tends to have a simpler premium rate structure than is typically found in insurance provided outside of superannuation.

The premium rates of the superannuation funds (taken from their PDS) considered within our analysis (refer to Section 4.1 for more detail) were analysed. The following is noted about the premium structure:

- 11 out of the 12 superannuation funds have unisex rates.
- Only one out of the 12 superannuation funds has default premium rates by occupation, whilst the remaining funds charge the same rates for blue and white collar members. In six superannuation funds, white collar members need to complete a short questionnaire to obtain white collar rates.
- In six of the 12 superannuation funds, unit rates are used across all ages, however, three superannuation funds have a lower number of default units for younger members. Only three superannuation funds have age related rates.

A simpler premium structure is easier to explain to members, however, it contains implicit cross-subsidisation for some segments, which means some members are paying more than the real cost of providing cover to them and others are paying less, for instance:

- unisex premium rates generally result in female members subsidising males for Death cover, as female mortality is typically lower than male mortality at the same age
- 'white collar' members are subsidising 'blue collar' members if premium rates for TPD are not differentiated by occupations; and
- younger members are subsidising older members if premium rates do not vary or vary insufficiently by age.

It is acknowledged that some level of pooling/averaging is necessary in insurance as it is a mechanism for pooling risk, for example in compulsory third party insurance. However, in the context of erosion of retirement savings, the higher the level of cross-subsidisation, the higher the level of benefit erosion. Although a young member will eventually receive the benefit of cross-subsidisation as they age, paying higher insurance premiums earlier has a material impact on a member's retirement savings as a lower amount accrues interest over a longer period.

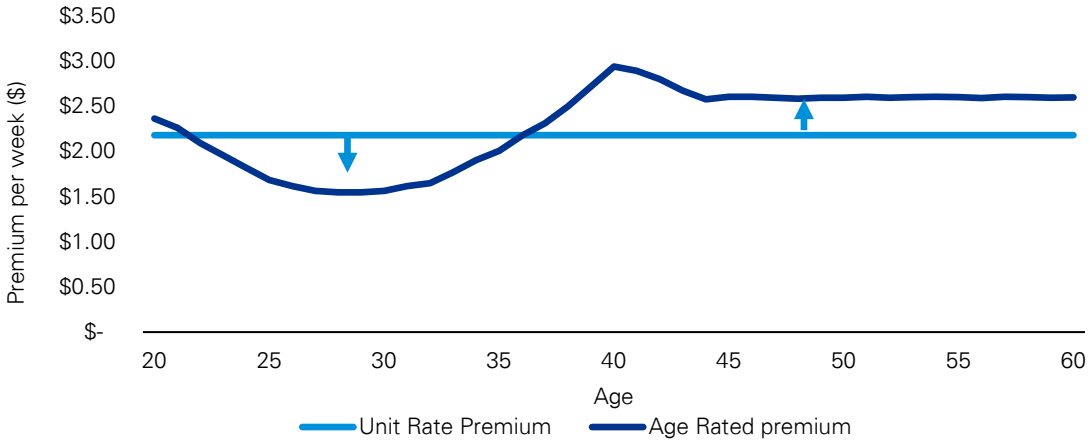
As an illustration of the level of cross-subsidisation that exists, let's consider the differential between a typical age-related rate and a unit rate in a superannuation fund.

Figure 13 compares typical age-rated[23] premiums and typical unit-rated[24] premiums by age for default Death cover in a superannuation fund. For example, for a member aged 22 to 35, the age-rated premium can be up to 29% less than the unit-rated premium. Similarly, the age-rated premium for members over the age of 36 can be up to 35% higher than the unit-rated premium.

[23] Age-rated premiums are where the premium charged to each member varies depending upon the age of that member.

[24] Unit-rated premiums are where the same premium is charged to all members of the fund irrespective of the age of the member.

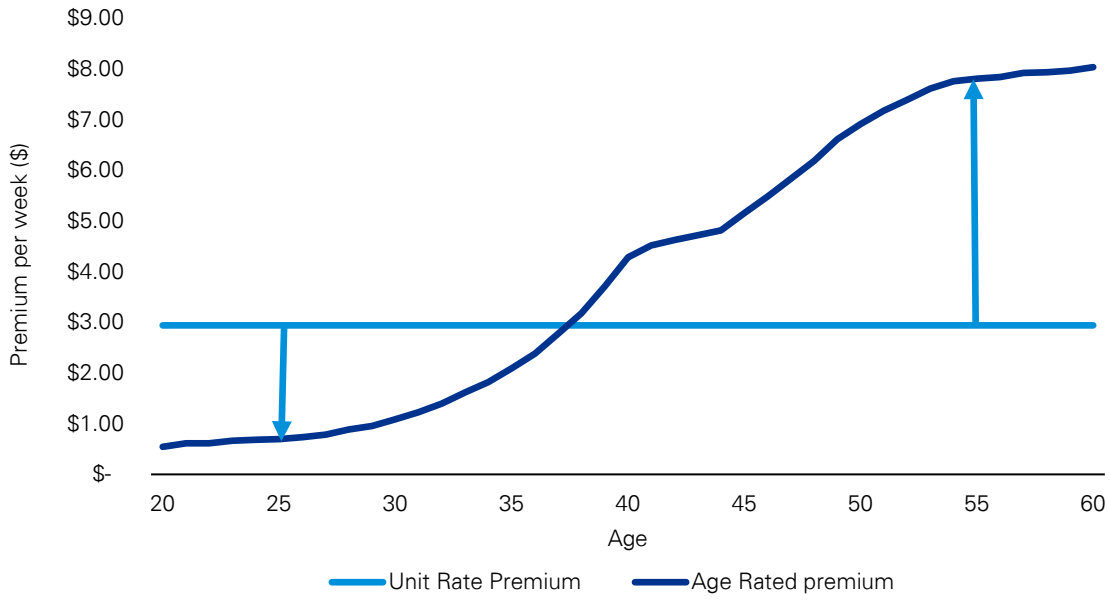
Figure 13: Death cover - unit-rate premium (default) vs age



Source: PDS of a superannuation fund

Figure 14 compares typical age-rated premiums and typical unit-rated[25] premiums by age for default TPD cover in a superannuation fund. For example, for a member aged 22 to 35, the age-rated premium can be up to 81% less than unit-rated premium. Similarly, the age-rated premium for members over the age of 36 can be up to 173% higher than the unit-rated premium.

Figure 14: TPD Cover - unit-rate premium (default) vs age-rated premium (fixed dollar cover)



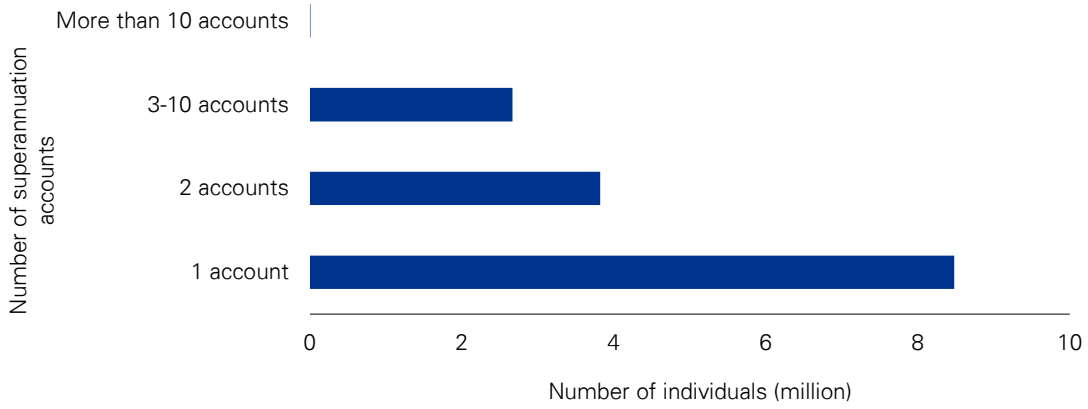
3.5 Duplicate superannuation accounts and insurance cover

It is a well-documented fact that there are a large number of Australians with duplicate superannuation accounts. According to the ATO, at 30 June 2016, there are over 14.9 million

[25] Unit-rated premiums are where the same premium is charged to all members of the fund irrespective of the age of the member.

people with at least one superannuation fund account[26]. Of these, 3.8 million (25.5%) have 2 accounts, and 2.7 million (18%) have between 3 and 10 accounts. This distribution is shown in Figure 15.

Figure 15: Number of individuals with duplicate superannuation accounts

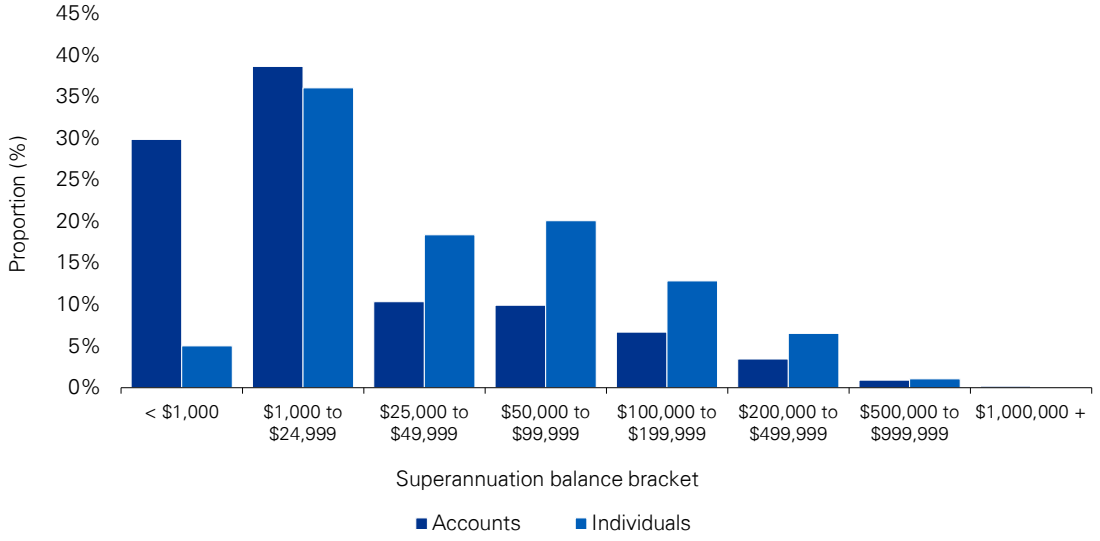


The characteristics of these duplicate accounts were analysed and the key findings are discussed below.

3.5.1 Small balances

In reviewing the distribution of superannuation balances (number of accounts vs. individuals) we utilised ATO and APRA data. The ATO publishes a distribution of the superannuation account balances per person using tax file numbers as the unique identifier. Additionally, APRA provides a distribution of accounts by size of account balance. Both are shown side by side in Figure 16.

Figure 16: Distribution of superannuation balances (accounts vs. individuals)



Source: ATO website and APRA statistics 2016

[26] ATO – Superannuation Accounts data overview.

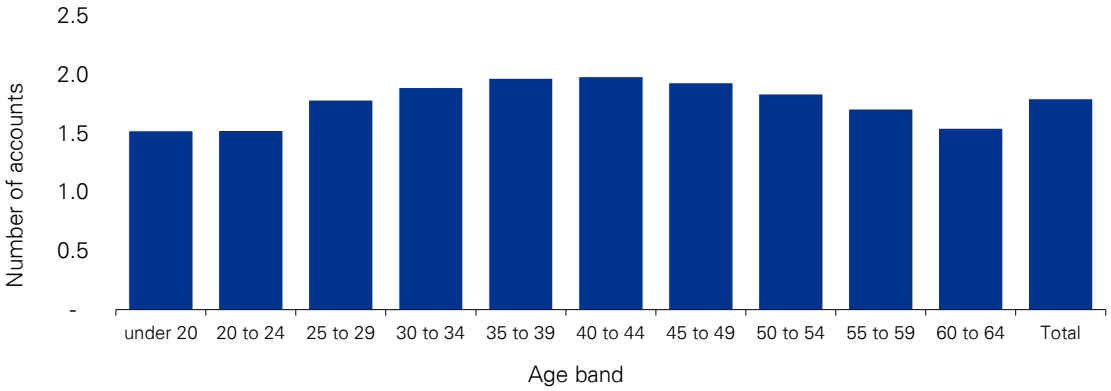
In the distribution of superannuation accounts, 30% of accounts had balances less than $1,000. The distribution of account balances by person, however, shows that only 5% of people have combined account balances less than $1,000. This implies that a large number of the duplicate accounts have superannuation account balances of less than $1,000. The fact that a large number of duplicate accounts have small balances is relevant when considering the impact of insurance on retirement savings and the effectiveness of cessation rules.

It is noted that some of these duplicate accounts may not have insurance cover, depending on the fund's cessation rules.

3.5.2 Duplicate accounts by age

Figure 17 shows the average number of accounts that people had by age as at 30 June 2016. It indicates that most of the duplication occurs prior to age 35. Thereafter, the average number of accounts per person stabilises and then reduces.

Figure 17: Average number of superannuation accounts by age band



Source: ATO – Superannuation Accounts data overview

The below cameo highlights the issue of duplicate accounts for younger members with lower account balances.

CAMEO: SARAH

Sarah is 23 years old, recently finished University and started a new full time role. Her starting salary is $50,000. During her time at University she worked part time and has $7,500 in superannuation with two superannuation funds.

When Sarah commences her new role, Sarah chooses her employer's default MySuper fund and as a result obtains a new MySuper account. Sarah now has three superannuation accounts, each with insurance cover. Insurance cover continues across all of her three superannuation accounts, with insurance premiums deducted from each, until the superannuation fund's cessation rules kick in.

Fund	Total premium deduction	How long was the deduction going for	Impact of insurance on superannuation balance
A	$38,988	42 years	$13,573 (62%)
B	$13,574	42 years	$10,118 (41%)
C	$10,118	42 years	$38,988 (4%)
Total			**$62,679 (6%)**

Because Sarah has three superannuation funds, she has on average $1,492 deducted from her account per year for insurance. The account balance in Funds A and B have been significantly reduced by insurance premiums, because of the duplication of accounts and insurance coverage. The reduction in retirement savings in Fund C is reasonable at 4%.

Under the current system, the trustees of Fund C may not be aware that Sarah belongs to two other funds; nor is Sarah aware that she has three levels of default cover in three different funds.

Upon retirement at age 65, Sarah's expected total account balance with default insurance cover is 6% less than her expected account balance if she had no default insurance. In dollar terms, Sarah's total superannuation account balance would have been $1,062,816 (without insurance) vs $1,000,137 (with insurance), a cost of $62,679 over Sarah's working life to retirement. In this case, the overall impact on Sarah's retirement savings is not unreasonable.

The impact on Sarah's retirement savings would have been higher had her salary been lower than in the example above. For example, had Sarah's salary been $22,000 instead of $50,000 and her salary remained low over her career, her premium deduction would have been unchanged, but her retirement savings would be lower. This means the impact of her insurance deduction would have been a reduction of 13% of her retirement savings, being a 7% difference.

For Sarah's full story, refer to Appendix C.1.

3.5.3 Other issues relating to duplication of accounts

The issue with duplicate accounts is that most are likely to have duplicate insurance, unless members are sufficiently engaged to instruct the trustees to cancel their insurance and cease their premium deduction once they leave the fund. This scenario is unlikely given most duplicate accounts remain dormant and they exist because members don't know they are there.

When the duplicate insurance contains IP cover, members cannot generally claim on multiple policies, given the total claim amount will be restricted to a maximum of 75% of their pre-disability income, and one policy will offset the other. When the duplicate insurance is Death or TPD, members can claim on both Death and disability policies and hence, there may be some value in retaining multiple levels of Death and TPD cover.

Another issue with duplicate accounts and insurance cover is that the trustees of superannuation funds are not aware of members having accounts with other superannuation funds, making it difficult for a trustee to determine the appropriate cover for members.

3.6 Summary of findings

- Default cover typically varies by age and very few superannuation funds segment their sum insured by occupation, salary or gender. Some superannuation funds have high lump sum Death and TPD cover for young members (up to $400,000 at age 18), while others have 'life-stage' cover, which provides lower levels of cover for younger and older members.

  Specifically, the average default Death, TPD and IP sums insured vary materially across age groups.

  - At age 20, the average default Death cover is $92,218, at age 30, $234,215, and at age 65, $18,476.
  - At age 20, the average default TPD cover is $97,398, at age 30, $155,322 and at age 65, $12,824.
  - The average IP cover does not vary as much by age as Death and TPD and is $1,553 per month at age 20, $2,225 per month at age 30 and $1,876 per month at age 64.

- Given there is significant variation in the level of the default sum insured amounts and the benefit designs utilised, there remain wide ranges in the cost of default cover between funds.
  - Specifically, Death insurance premiums for a male aged 30 can vary from $1.04 per week to $4.28 per week depending on the superannuation fund to which they belong. Default TPD premiums can vary between $0.50 and $8.50 per week for a 30 year old male, whilst IP premiums vary substantially depending upon the waiting period and benefit payment period and sit between $0.40 and $4.50 per week for a 30 year old male.

- The majority of superannuation funds do not provide default IP benefits. Of the 12 superannuation funds analysed, only 50% provide default IP cover.

- Default cover tends to generally have a simpler premium structure than tailored insurance cover. From our review of the information contained in superannuation fund PDS, premium rates in many funds are unisex, or do not distinguish between 'blue' and 'white collar' occupations, or are uniform across a large range of ages. A simpler premium structure is easier to explain to members, however, does contain large, implicit cross-subsidisation. Some member segments, such as females, 'white collar' or young people are, in many instances, paying more than the real cost of maintaining cover, which further emphasises the challenges associated with the erosion of benefits for these members.

- There remains a significant level of duplication of accounts and of insurance within the superannuation industry, albeit the majority of duplicate accounts have small balances. Some superannuation funds have attempted to address this by introducing insurance cessation rules, but this is not common practice. Although the average level of default cover is not excessive, some members are paying for duplicate cover that they cannot access, specifically in relation to IP.

4. The impact of default group insurance

The impact of the current arrangements for default group insurance on retirement savings has been examined by constructing a model of the current population of members who have default group insurance in superannuation. The model is intended to reflect the current age and gender distribution as well as the amount and type of cover, the size of account balances and the level of duplication of accounts.

4.1 Determining the data set

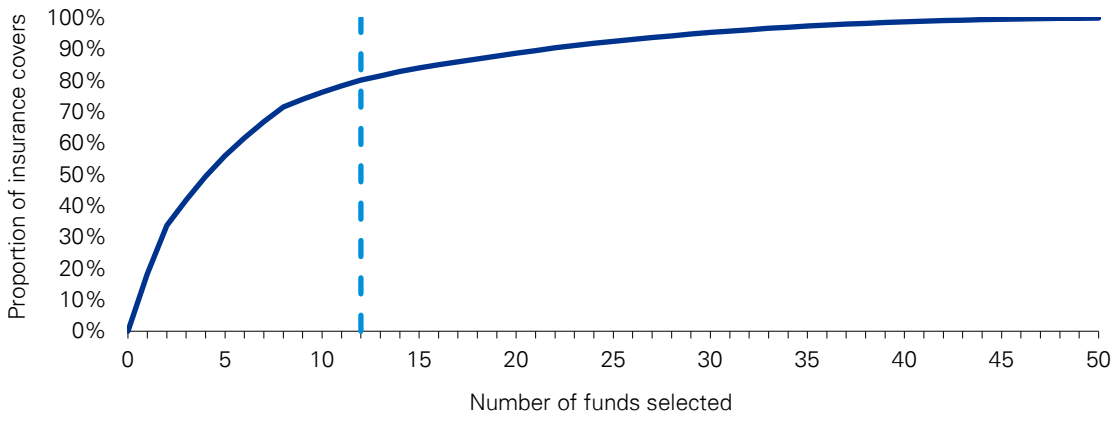
In examining the impact of default group insurance in superannuation on retirement savings, insurance data relating to the MySuper products of 12 superannuation funds (including both industry and public sector funds) has been used. Appendix A lists the 12 superannuation funds.

Our reasoning for using this population set of 12 superannuation funds (industry and public sector MySuper funds) is as follows:

- a single default insurance option, rather than multiple default insurance options
- insurance premiums and benefit design/data is publicly available
- together these funds constitute 76% of all MySuper accounts. Within MySuper, the 12 superannuation funds constitute approximately 60% of all MySuper accounts with insurance and 80% of all industry and public sector MySuper accounts with insurance.

To obtain data in respect of an additional 10% of the population, it would be necessary to add a further 11 funds to this analysis. This diminishing return is illustrated in Figure 18.

Figure 18: Number of superannuation funds vs. proportion of MySuper accounts with insurance represented



Source: APRA MySuper Statistics June 2016

Further to this point, it is recognised that retail and corporate superannuation funds also offer default group insurance. Data in relation to this cover was requested, but was not available for the purpose of this report. Furthermore, we have not made specific allowance for retail and corporate superannuation funds for the following reasons.

1. Benefit designs are usually age and salary related, rather than a fixed dollar amount.
2. The default product design for retail superannuation funds varies considerably between different employers and within different employer divisions.
3. Premium rates for corporate and retail superannuation funds are highly tailored and are not publicly available. Further, tailored employer default cover remains a significant part of a retail superannuation fund's default cover, unlike industry funds and public sector funds, where MySuper makes up the majority of default superannuation cover.

To verify that the default group insurance cover provided by the 12 superannuation funds is representative of the default group insurance cover provided by all superannuation funds under MySuper (including retail and corporate superannuation funds), the cover and premiums for members aged 30 and 50 are set out in Tables 7 and 8 below. They show that the 12 superannuation funds average cover levels and average premium rates are, in most instances, within 5% of the same statistics for MySuper (in total), and in one case is less than 10% outside of the MySuper average.

Table 7: Comparison of MySuper average default insurance cover vs selected funds

Average cover by benefit type	Age 30		Age 50		12 funds selected vs MySuper	
	MySuper	12 funds selected	MySuper	12 funds selected	Age 30	Age 50
Death	$213,631	$234,215	$113,070	$117,831	109.6%	104.2%
TPD	$164,052	$155,322	$85,263	$72,865	94.7%	85.5%
IP*	$2,233	$2,225	$2,197	$2,162	99.6%	98.4%

* IP cover per month

Source: APRA MySuper Statistics June 2016

Table 8: Comparison of MySuper average annual premium per $1,000 default insurance cover vs selected funds

Average cover by premium type	Age 30		Age 50		12 funds selected vs MySuper	
	MySuper	12 funds selected	MySuper	12 funds selected	Age 30	Age 50
Death	$0.63	$0.62	$1.86	$1.79	98.7%	96.3%
TPD	$0.95	$1.00	$3.10	$3.17	105.6%	102.4%
IP*	$143.38	$153.90	$204.53	$211.30	107.3%	103.3%

* IP premium is per $1,000 per month of cover

Source: APRA MySuper statistics 2016 and Funds' Product Disclosure Statements

In this report, we have analysed members in MySuper as a representation of default superannuation, and within MySuper, we have considered 12 superannuation funds' default group insurance arrangements as a reasonable representation for MySuper default group insurance.

4.2 Approach

The impact of default group insurance in superannuation on retirement savings was estimated by modelling superannuation account balances of the population with and without insurance, allowing for differences due to age, income level/superannuation account balance, and gender. Segments such as low income earners, young members (age < 30) and females are commonly perceived to be most impacted by the current default group insurance cover arrangements.

A four step process was used to estimate the cost of default group insurance to members, using a bottom-up approach:

- A model point file was created such that the key characteristics of default cover in the 12 superannuation funds were replicated. The file replicates the age and gender distribution of each of those superannuation funds, weighted by the size of the superannuation fund to which the member belongs.
- The premiums, insurance cover and cessation rules were modelled according to the rules set out in each of the superannuation fund's PDS.
- Projection assumptions were determined, such as future wage growth, salary scale and investment returns (net of fees and tax). These are disclosed in Appendix B.
- SGC, account balances and insurance premiums of each sample member were projected until retirement age to determine the cost of default group insurance relative to contributions and the impact on the account balance at retirement.

The analysis considers the impact of future insurance premium deductions, given the current account balances. As the starting point is the current account balance, this analysis does not comment on the impact of past premium deductions on retirement savings and hence, should not be taken as a lifetime impact. However, the impact on a young member (age 18 or less) is indicative of the impact over a person's lifetime on his or her retirement savings.

Further details of the model and assumptions are provided in Appendix B, including a discussion of any identified limitations.

4.2.1 Top down validation

In identifying the total population of members and cost of insurance, we used industry superannuation and insurance data (as published by the APRA) and population statistics (as published by the Australian Bureau of Statistics (ABS).

The advantage of combining a top down approach with the bottom up approach is that it enables a check to be performed at the total population level, ensuring results are also reasonable at a high level.

4.2.2 Data sources

The analysis undertaken is supported by the following data:

- Industry superannuation and insurance data was used to estimate the population of members with default insurance, and the default cost and benefits offered.
- Population data was used to ensure that the sample members and projection results are not inconsistent with Australian population statistics, for example the implied participation rates by age group are reasonable.
- A sample file of 2% of the ATO's tax returns was used to link income, age and account balance. The sample file consists of 258,774 individual records. The sample file was also used to estimate the distribution of duplicate account balances and the salary scale.

Further details are outlined below.

Industry superannuation and insurance data

The key data sources for the industry data used in this report are:

- APRA statistics – which provided information on superannuation accounts, including insurance coverage by fund, as well as information on the aggregate level and cost of insurance in Australia; and
- insurance premiums and benefit data obtained from the 12 superannuation funds' PDS.

Population data

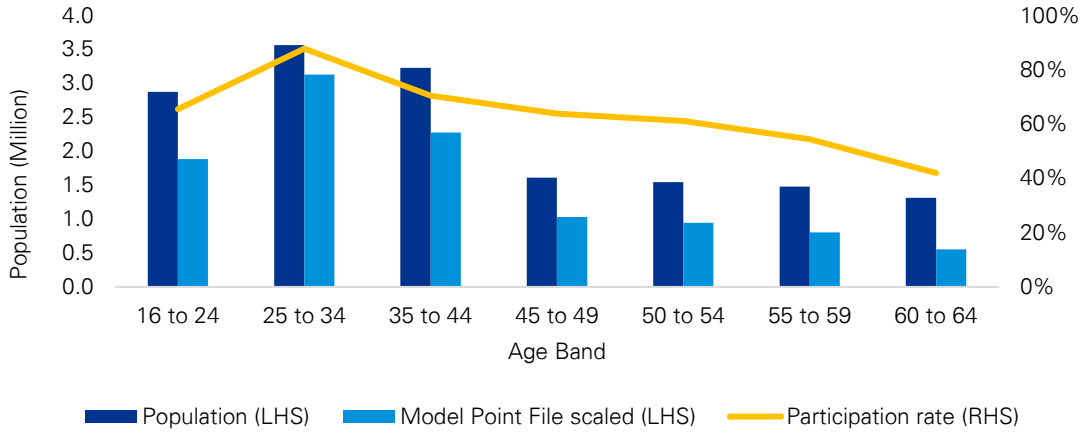
Population data was primarily obtained from the ABS based on the 2011 census results rolled forward to June 2016.

This is the latest information published by the ABS at the time of writing this report.

This data was used to verify that the sample member file constructed based on each superannuation fund's age distribution as disclosed in the APRA statistics represents a reasonable proportion of the Australian population by working age.

This is shown in Figure 19, with the participation rate (as shown by the yellow line) representing the proportion of the population in each age group that has default group insurance within superannuation. For example, for the 25 to 34 age group, 3.1 million people out of a total population of 3.5 million are working, a participation rate of 88%. This shows that model point files are a good representation of the total population.

Figure 19: Population versus scaled sample member file



It is possible in future refinements to the projection to incorporate expected future changes to the participation rate by segments, for example, more female participation between ages 30 and 45, more part time work for both genders and people working past age 65. However, for the purpose of this report, we have not anticipated these trends.

ATO sample file

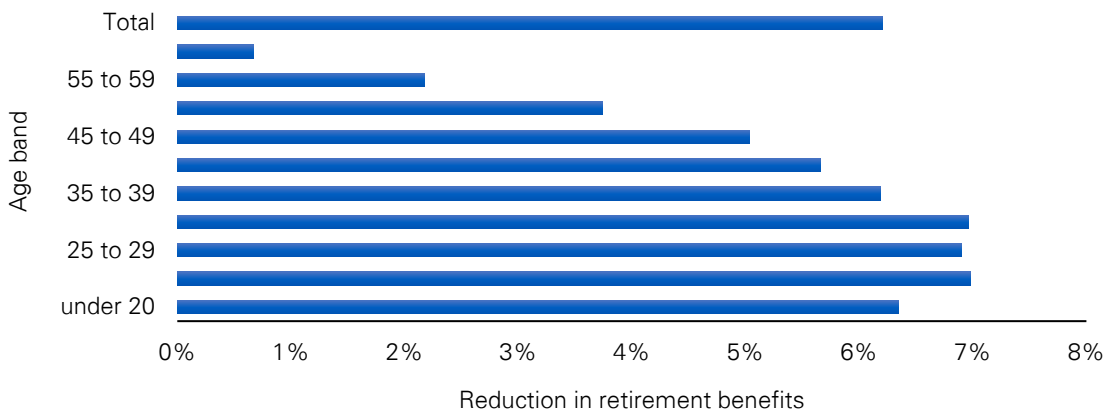
A sample file of 2% of the ATO tax returns was used to link income, age and account balance. It was also used to estimate the distribution of duplicate account balances and the salary scale. The data set was adjusted to exclude Self-Managed Superannuation Funds (SMSFs), which have much higher account balances than the average and are not considered to be representative of the broader population, given they do not have default group insurance as a feature.

4.3 Findings

4.3.1 Reduction of retirement savings due to default insurance

Our analysis indicates that retirement savings can be expected to reduce by 6.2% on average due to the payment of default group insurance premiums. However, it is the impact by segment that is of real interest. The impact is shown in Figure 20 by age group.

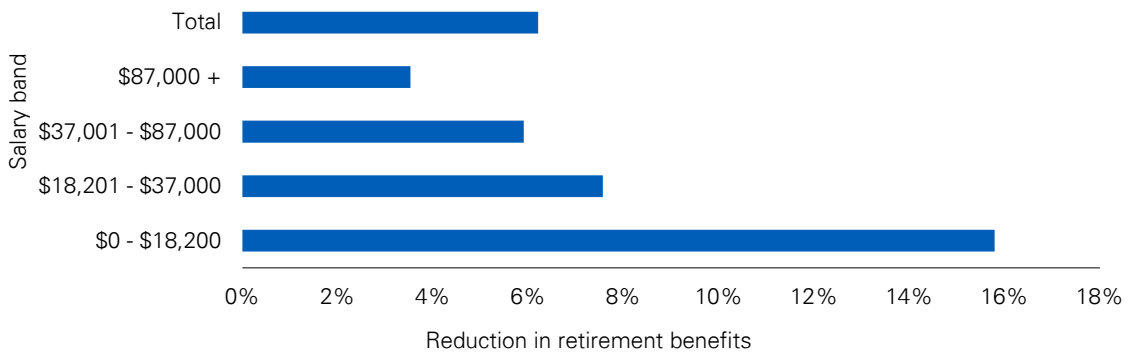
Figure 20: Reduction of retirement savings by age group



- The greatest reduction in retirement savings by age is for members who are aged up to 34 (7%). The impact reduces for every age group after age 34, until the impact is less than 1% at age 60 to 64.
- The reduction of the impact from age 35 is not unexpected, due to older members having fewer years to retirement, hence these members should be less affected. Further, this projection starts with today's picture of members' account balance and therefore cannot illustrate the impact of past deductions.
- To understand the impact of insurance premium deductions over a member's working lifetime, the reader should focus on the impact on a younger member. For example, the impact of default insurance cover at the average amount for a male member who is aged 22, and earning an initial salary of $20,000 is projected to be a 12.6% reduction in retirement savings.

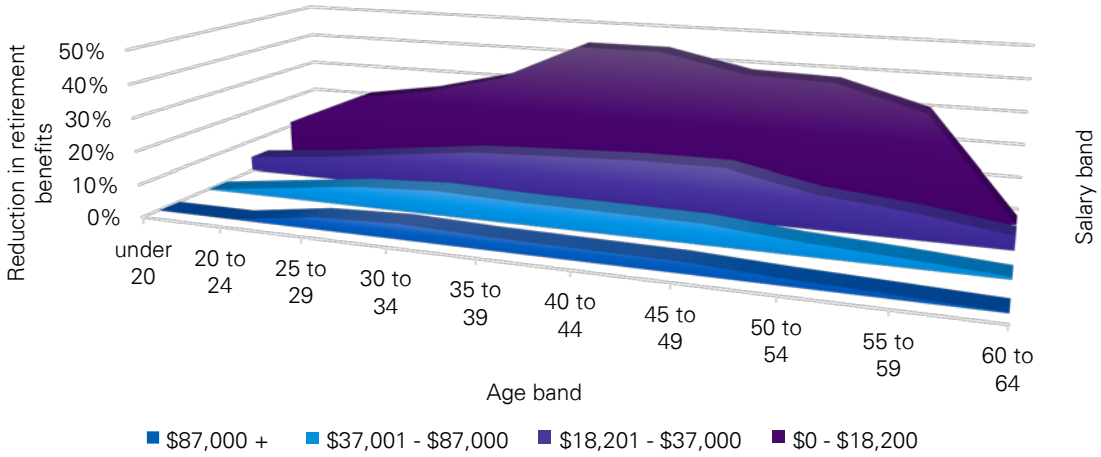
When examined by salary level, it is apparent that the impact on low income earners is much higher than the average. Specifically, members who earn less than $18,200 have their retirement savings reduced by 16% as a result of default group insurance premiums compared to 8.6% for those who earn a more typical level of income ($37,000 to $87,000). This is illustrated in Figure 21.

Figure 21: Reduction in retirement savings by salary level



When examined by both age and salary, an even more informative picture emerges, per Figure 22.

Figure 22: Reduction in retirement savings by salary level and age - current state



The impact on the retirement savings of members earning less than $18,200 is higher than other salary levels at all ages.

- For members under age 20, the expected account balance impact is 11% if salary is less than $18,200 compared to an account balance impact of 5% for people earning between $18,201 and $37,000.
- There is significant correlation between low salary and low account balance. Members with low superannuation contributions tend to also have lower account balances, which means that a fixed dollar amount of insurance cover could represent a larger percentage of their SGC and their account balance, hence producing an unusually large erosion of retirement savings. For example, there are individuals in the population (represented in the tax file) who are aged between 35 and 45, earn less than $18,200 in annual income, and have less than $1,000 in their superannuation account. For these members, insurance premiums under the current system can represent as much as 44% reduction in retirement savings.
- Although only 5% of the population have a salary below $18,200 and 5% of the population have an account balance less than $1,000, this analysis indicates that these individuals' retirement savings can be expected to be significantly impacted by default premium deductions. This in turn suggests that these members need special consideration when designing default group insurance benefits.

The below cameo is an example of the impact of insurance premiums on a low income earner.

CAMEO: JOHN

John is 18 years old and is an apprentice chef. John currently earns $10,000 per year and has $500 in superannuation with Fund A.

John remains employed as a chef at the family owned restaurant throughout his career with minimal progression in his salary.

Upon retirement at age 65, John's total retirement balance is estimated to be $151,351. The impact of insurance premium deductions is to reduce his retirement balance by 15%.

Fund	Expected superannuation balance (with default insurance)	Expected superannuation balance (with no default insurance)	Impact of insurance on superannuation balance
A	$151,351	$178,801	$27,450 (15%)

For John's full story, refer to Appendix C.3.

Alternatively, the below cameo describes what would happen if John had selected another superannuation fund with higher default cover.

CAMEO: JOHN (Alternative)

In this scenario, John elects an alternative superannuation fund with higher default insurance cover, including default IP cover.

In Fund A, John's insurance premiums would reduce his retirement balance by $27,450 to $151,351. In the second scenario, John's insurance premiums would reduce his retirement balance by $61,259 to $117,542.

Fund	Expected superannuation balance (with default insurance)	Expected superannuation balance (with no default insurance)	Impact of insurance on superannuation balance
B	$117,542	$178,801	$61,259 (34%)

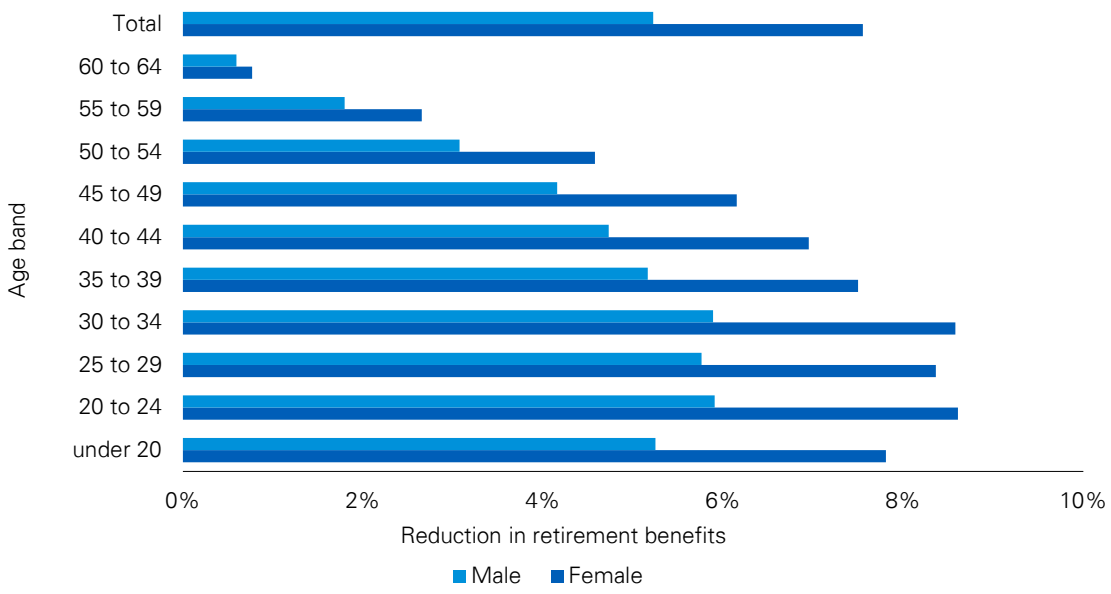
As is evident from the above, the impact of having IP cover and the higher levels of Death and TPD cover on John's retirement balance is a materially higher reduction, moving from 15% to 34% of his final retirement balance.

For John's full story, refer to Appendix C.3.

4.3.2 Reduction of superannuation balance at retirement due to insurance – by gender.

The projection shows that on average, female superannuation balances at retirement are reduced by 7.6% as a result of default group insurance premiums, compared to a 5.2% reduction for males. At every age, the impact on female members is higher than for males of an equivalent age. This is illustrated in Figure 23.

Figure 23: Impact on retirement savings Male vs Female



This result reflects a key feature of the sample tax file, which has in turn been replicated in our sample member file. Specifically, female taxpayers' salaries[27] are on average lower than those of male taxpayers ($44,000 vs $67,000). Further, males and females have different patterns of salary increases by age. Between ages 30 and 50, female salaries stop increasing,

[27] From the ATO sample file of taxpayers' characteristics.

possibly reflecting a different pattern of work (part time vs full time). Details of the salary scale is provided in Appendix B.

CAMEO: LISA

Lisa is 28 years old, and works as a primary school teacher. She is starting a new full time role with a salary of $45,000. After working as a substitute teacher over the past 3 years, she has $4,500 in superannuation savings.

At age 30, Lisa has her first child and goes on maternity leave for one year, of which 3 months is with pay. She returns to work on a part-time basis and has her second child at age 33. Lisa decides to stay at home until both her children are in high-school. At age 45, Lisa returns to work on a full-time basis.

Lisa does not make any superannuation contributions after leaving work at age 33. Her IP cover cancels 12 months after the superannuation fund ceased receiving contributions for her. The superannuation fund will also cancel lump sum insurance cover if her account balance reduces below $3,000, however, her account balance remains above $3,000 while she was out of the workforce.

Lisa's IP cover resumes at age 45 when her employer re-commences contributions to her fund.

Upon retirement at age 65, Lisa's total retirement balance is estimated to be $220,092, in comparison to the balance she would have if she had opted out of insurance of $246,711. The impact of insurance on her retirement balance is $26,619 (11%).

In Lisa's case, the design of the superannuation fund's cover and cessation rule in respect of IP made a difference to the impact upon her retirement savings. Had they not been in place, the level of erosion for Lisa would have been 13%.

For Lisa's full story, refer to Appendix C.4.

4.4 Summary of findings

Our key findings are summarised as follows:

- Default insurance premiums are estimated to reduce retirement savings by 6.2% overall. However, this reduction varies greatly between segments, as can be seen in Table 9.

Table 9: Average reduction in retirement savings

Category	Segment	Impact on retirement savings %	Segment	Impact on retirement savings %
Gender	Female	7.6%	Male	5.2%
Age	Under 30	7%	45 to 65	4%
Income	Salary < $18,200	16%	Salary > $87,000	3%

- Low income earners, females and younger people's retirement savings are impacted more than their counterparts. Females tend to be over-represented in the group of low income earners, which further compounds the quantum of the reduction of retirement savings for these groups.
- Low income levels have the largest effect on the impact on retirement savings, more so than age and gender. For example, the impact on retirement savings for females aged

35 to 39 earning between $18,200 and $37,000 is 14%, compared to 44% for females of the same age earnings less than $18,200.

We recognise, however, that the design of the default cover can significantly mitigate the impact on retirement savings, as illustrated in John's and Lisa's examples above.

Some superannuation funds have cessation rules in place to address a number of these issues, particularly with regard to IP cover. The cessation rules specify that premiums will cease being deducted either when a dollar amount limit is reached or where contributions have not been made for a member for 12 months. Given these rules, the worst case scenario for benefit erosion is for members who have their superannuation balances divided more or less equally between three or four accounts, each of which have insurance. Members who have most of their account balance in their active account and minimal amounts in their inactive account are less affected.

5. Assessing the impact of potential changes to default group insurance

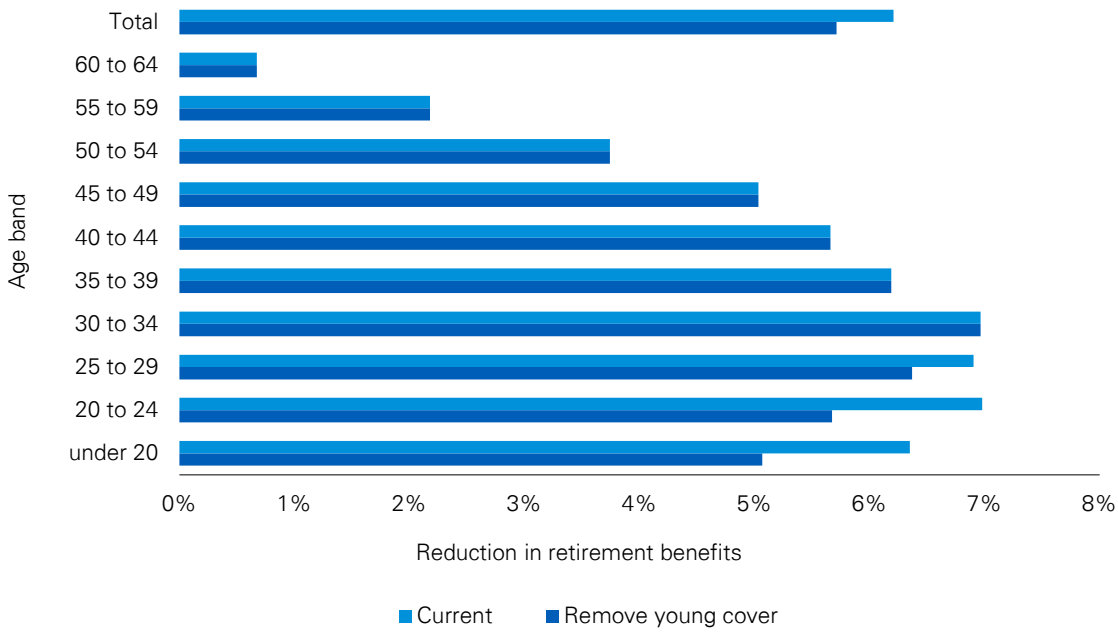
In this section, the impact of the following potential modifications to default group insurance arrangements within superannuation is examined:

- removing default group insurance cover for younger members (under 30 years of age)
- removing the duplication of insurance cover
- changing the current (opt-out) default group insurance to opt-in insurance cover.

5.1 Removing default group insurance cover for younger people

In order to protect the retirement savings for younger people, one suggestion has been to consider removing all default insurance for members under age 30. The impact of removing default group insurance cover for under 30 year olds is illustrated in Figure 24.

Figure 24: Impact on retirement savings - before and after the removal of cover for members under the age of 30



For members under the age of 30, if default cover did not commence until they are over age 30, their retirement savings at 65 can be expected to increase compared to maintaining cover for under age 30, as shown in Table 10.

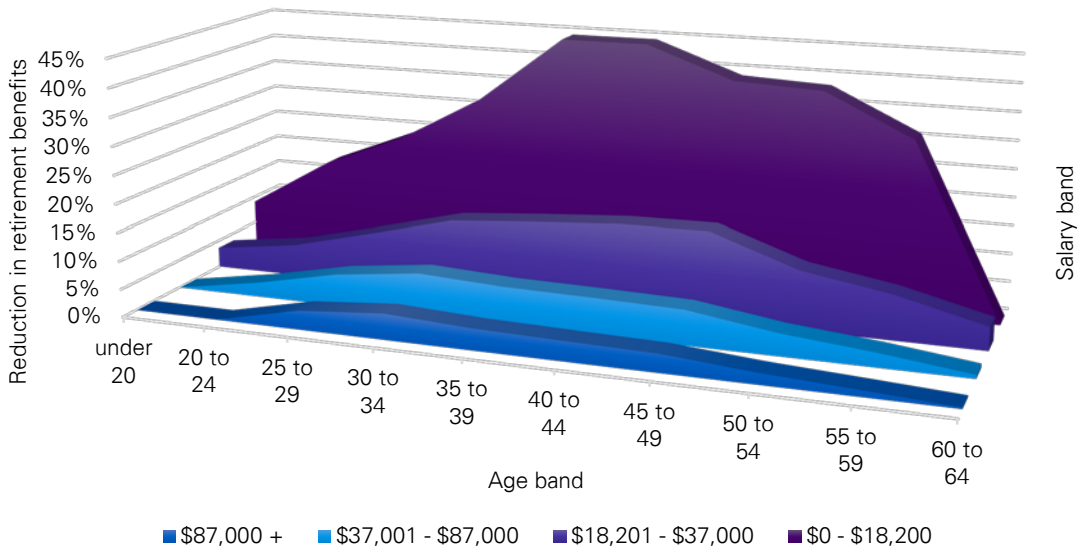
Table 10: Impact on retirement savings (under the age 30)

Age	Increase (%)
Under 20	1.3%
20 to 24	1.3%
25 to 29	0.5%

Impact by salary level and age group

When examined by salary level and age group, our analysis indicates that the removal of insurance for individuals under age 30 would result in an increase in retirement savings overall for younger people. The impact on low income earners remains the most significant, irrespective of age, as illustrated in Figure 25.

Figure 25: Reduction of retirement savings by salary and age - no default insurance for under 30



Other considerations

- Excluding younger members from default group insurance cover may result in premium increases for the remaining members as this would increase the average age of the insurance pool, given that younger members generally cross-subsidise older members. It is estimated that insurance premiums may need to increase by between 5% and 15% to compensate insurers for the amended higher average age of the insured population. The impact on insurance premium levels may vary by superannuation fund depending upon the fund demographic and the current level of premium cross-subsidisation within the fund.

- We note that people under age 30 may have insurance needs: 40% to 45%[28] are married, or have dependants and 20 to 25%[29] have a mortgage. As such, removing default insurance cover for these people will also remove the benefits of having insurance for them at the same time.
- If all default group insurance cover was removed from members under the age of 30, in the short term, default group insurance revenue is projected to decrease by 16% compared to the current level. This is approximately $700 million per annum or 8% of total annual group insurance revenue.
- It is estimated that total underinsurance for Death insurance will increase by $225 billion to $250 billion and for disability insurance will increase from $10 billion to $12 billion, if default group insurance cover is removed for members under the age of 30.

5.2 The impact of duplicate accounts and associated insurance

In this section, the impact on members' retirement savings if duplicate accounts (and hence the duplication of insurance) were removed is examined. For the purpose of this report, we have assumed that the active account, where the majority of a member's superannuation balance is usually held, will continue to maintain default group insurance cover. Under this scenario, all duplicate accounts will cease to have default group insurance, whilst any other voluntary insurance and top up insurance continue to exist.

Our modelling shows that removing duplication of insurance cover can be expected to reduce the impact of insurance in superannuation on retirement savings from 6.2% to 6.0%. Despite the high level of superannuation account duplication, the reduction of the impact on retirement savings is modest.

The main reasons for the low impact of removing duplicate insurance is that many of the duplicate accounts have very small account balances. Which means that less money can be deducted from those superannuation accounts before the cessation rule takes effect or the account balance reduces to nil. Cessation rules have been introduced by some superannuation funds, which are aware of this issue and have acted to protect members' savings from being unduly eroded by insurance premiums.

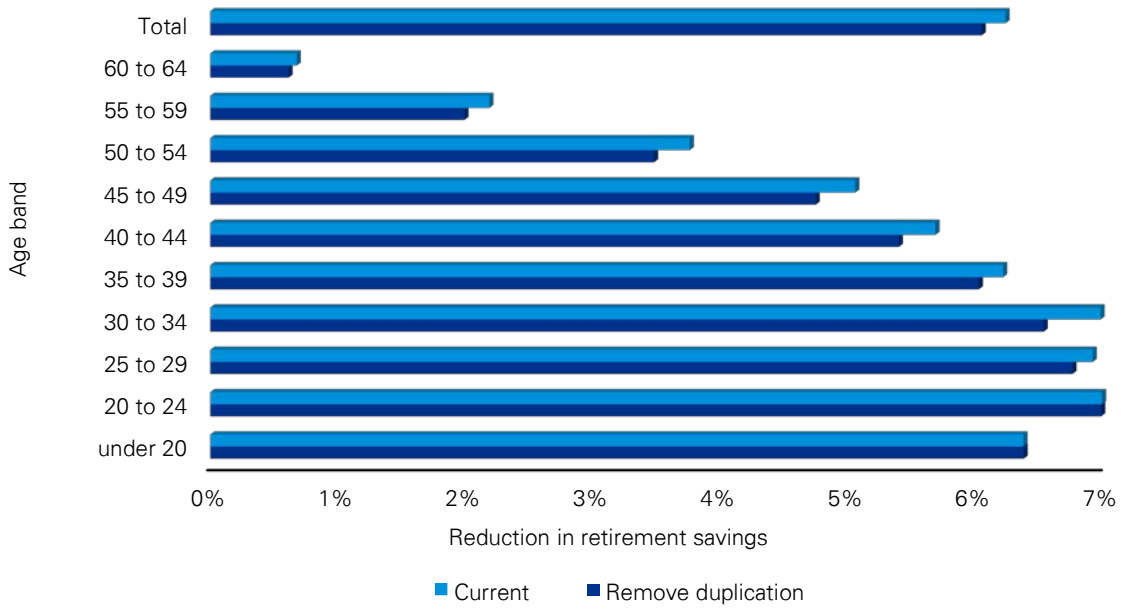
Impact by age

The impact of removing account and insurance duplication varies by age. The age groups that benefit the most from the removal of duplicate insurance are the older age groups, and not under 30s, as might have been expected. The age bracket that will benefit the least is those under age 25, because they have had the least time in which to acquire duplicate accounts and the account balances in any duplicate accounts are likely to be very low.

Figure 26 illustrates the impact of duplicate account removal across different age groups.

[28] ABS Data - 44420DO011_20122013 Family Characteristics and Transitions, Australia, 2012-13 and KPMG analysis.
[29] ABS Data - 4130.0 - Housing Occupancy and Costs, 2013-14 and KPMG analysis.

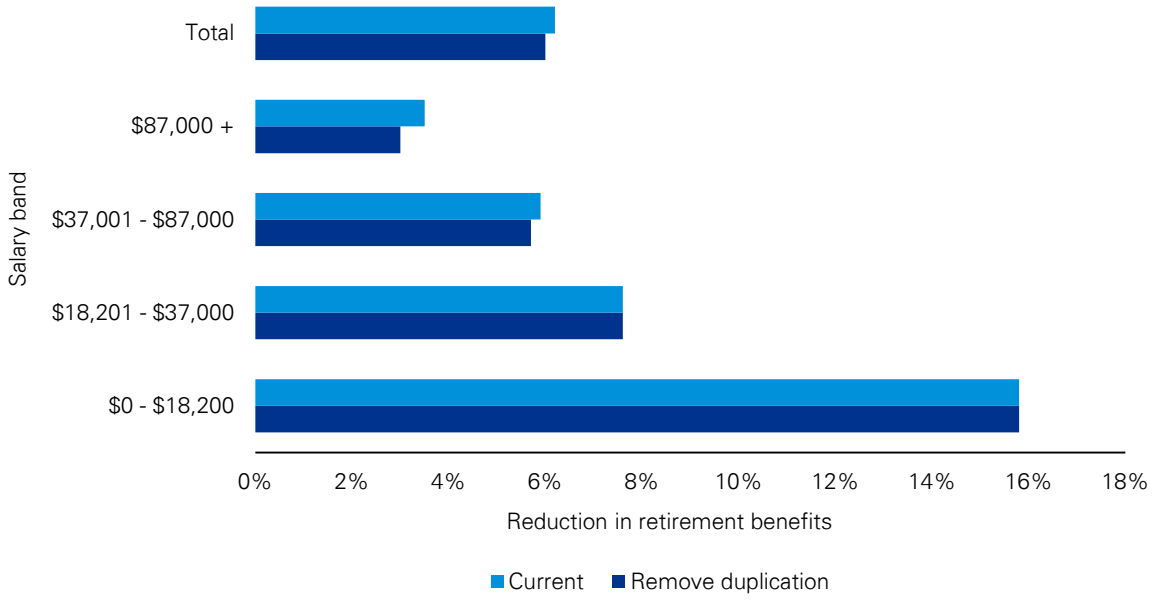
Figure 26: Impact on retirement savings - before and after removal of duplication



Impact by salary level

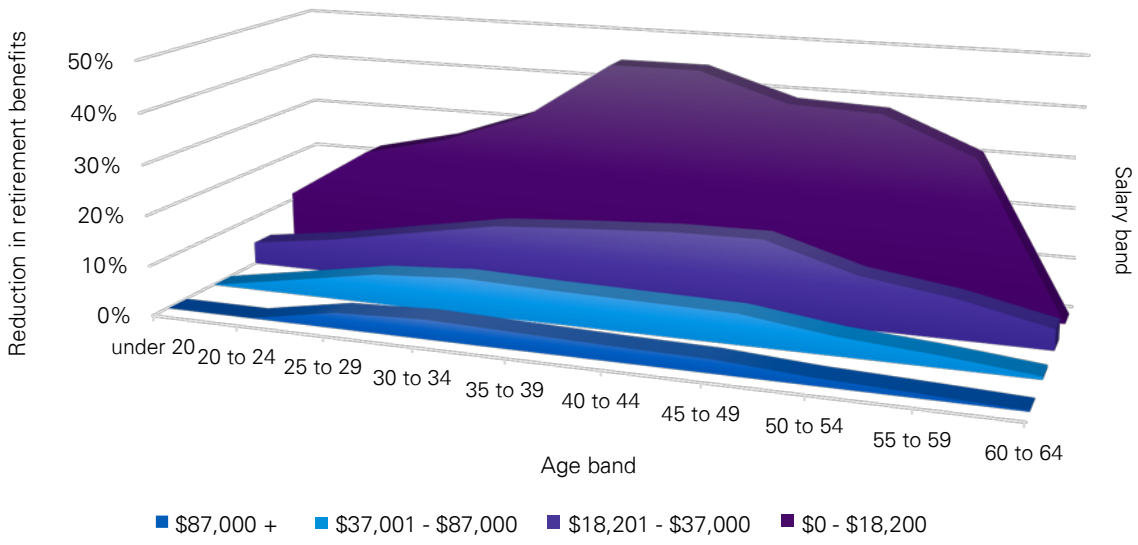
The impact of removing duplication varies by salary level. The largest increase in retirement savings (0.5%) is expected to occur for higher income earners ($87,000+).

Figure 27: Impact on retirement savings - before and after removal of duplication



Our analysis indicates that when examined by salary level and age group, the most impacted group remains the low income earners, irrespective of age.

Figure 28: Reduction of retirement savings by salary level and age - no duplication



Cessation rule and duplication

A number of superannuation funds have cessation rules in place, which aim to limit potential erosion of retirement savings in relation to duplicate insurance. For example, insurance premiums would not be deducted either once a member's superannuation account balance falls below a specified dollar amount, or 12 months after contributions cease. The account balance for ceasing cover ranges from $1,000 to $10,000 across the industry.

As there is no requirement to cease insurance when contributions stop, many of the 43% of members who have more than 1 account may have duplicate insurance cover.

Another consideration is that, due to the range of default group insurance cover designs in the industry, automatic removal of duplicate cover may leave some members with less than ideal cover.

This is evident in the cameo for Bob, who consolidated his two superannuation accounts with insurance, without assessing the impact of the consolidation on his insurance cover.

CAMEO: BOB (Alternative)

In section 3.3, we met Bob who maintained two superannuation funds, each with default insurance cover. This cameo is the alternative scenario where Bob consolidated his superannuation account Fund X into Fund Y, but did not consider the impact of losing his insurance cover in Fund X when he consolidated.

When Bob became ill, Bob was only able to claim IP benefits from one fund, Fund Y. The amount that Bob is able to claim from Fund Y is a total of $60,000 over the 2 year benefit period.

Importantly, when consolidating his superannuation accounts, Bob was not aware that Fund Y had lower IP cover than Fund X. Bob's decision to consolidate superannuation accounts and insurance cover meant that when he claimed, he effectively missed out on $349,500 of IP benefits, compared to the previous cameo. On the other hand, Bob's retirement balance will be $576,384 ($41,283 higher) due to his decision to consolidate insurance cover and not pay two sets of premiums.

For Bob's full story refer to Appendix C.2.

While removing duplicate insurance from superannuation accounts seems to be a reasonable efficiency measure, the analysis suggests that removing the duplicated cover may not have the intended effect as it does not materially impact the retirement savings of low income earners, younger people or females and, in fact, may benefit older members or higher income earners more.

5.3 Change from opt-out to opt-in

Under this scenario, default group insurance is removed from each superannuation fund's offering. Instead members would be required to opt-in to have insurance within superannuation at their discretion. If this was to occur, we would expect the following:

- There will be a low rate of take up, expected to be between 2% and 10% of members. This behaviour is consistent with the low take up rate of voluntary cover in current superannuation funds where this is available.
- Introducing an opt-in arrangement can be expected to increase the level of underinsurance in the community. Based on a take up rate of 5% for people under 30, 10% of people between 30 and 44 and a 15% take up rate for people aged 45 or over, the underinsurance for Death[30] is expected to triple, increasing from $800 billion to $2.4 trillion. The underinsurance level for disability is expected to increase by 41%, from $304 billion per annum to $428 billion per annum. The underinsurance is measured against an adequate level of insurance, as defined in the KPMG underinsurance report[31].
- If the take up rate were double the rates above, the underinsurance level for Death is expected to increase by 128% from $800 billion to $1.821 trillion and disability underinsurance would increase by 23% from $304 billion to $374 billion, which remains material.
- The premium rates for those members that do opt-in to insurance would be likely to be materially higher than the current group insurance rates offered by superannuation funds, consistent with the need and cost to undermine the reduction in volume and the need for insurers to spread their expenses across a smaller revenue base.
- There may be reduced access to insurance under an opt-in system. Members from some industries, such as the construction or mining industry, may have difficulty obtaining insurance cover on an opt-in basis for their members. The members who opt-in may be subject to underwriting and may be asked to pay a higher premium or have exclusions or loadings applied to their cover. We estimate that:
  - at least 5%[32] of people would be unable to obtain insurance at standard rates, based on the percentage of insured lives who require a loading or have an exclusion

[30] Relative to an adequate level of insurance (as opposed to basic or comfortable).

[31] KPMG report - Death and TPD underinsurance 2013, Disability Income underinsurance 2013.

[32] Source: http://www.abs.gov.au/ausstats/abs@.nsf/mf/4433.0.55.006

- based on our understanding of current insurance practices, another 25%[33] of people would have a loading or an exclusion based on their occupation, industry, their employment status (casual, contracting or permanent), or an existing disability
- consequently, between 4 million and 5 million people would not be able to obtain insurance at all or at reasonable rates under an opt-in system, whereas at present they can obtain default cover without the need for underwriting.

[33] Source: http://www.abs.gov.au/websitedbs/censushome.nsf/home/CO-65#occupation and KPMG analysis of rating practices.

6. An international perspective

The pension schemes of seven countries (Canada, Chile, France, New Zealand, Sweden, United Kingdom and the USA) were researched at a high level, to compare and contrast with the Australian system of compulsory superannuation with regards to default group insurance. Sweden and Chile are considered to have more generous retirement savings provisions, while the remainder of the group are considered to have comparable, albeit different, provisions to Australia.

Australia is the only country (within the sample group) to provide default opt-out group insurance within their superannuation funds/pension schemes. Canada and Chile both offer default group insurance in their pension schemes but under a different benefit structure, and there is no option to opt-out.

Insurance benefits received under the Canadian Pension Plan (CPP) include:

- Disability: if the contributor becomes severely disabled to the extent that they cannot work at any job on a regular basis
- Survivor's pension: The surviving spouse may receive a pension on the death of the contributor
- Death benefit: a one-time payment to the estate of a deceased CPP contributor
- Children's benefit: monthly payments to the dependent children of a disabled or deceased CPP contributor.

The Chilean Pension System (*Sistema Provisional*) provides old-age, disability and survival pensions for workers in Chile. The pension plan purchases a group life policy that provides lifetime disability and survival benefits. The premium is included as part of the administration fee, with no allowance to opt-out. The benefits received are all funded by member's contributions and include:

- A temporary disability benefit (either total or partial) payable for up to 3 years, which is financed by the worker's pension plan.
- After 3 years, a higher level assessment is used to determine permanent disability. The funds in the worker's account are used to finance the permanent disability benefit which is equal to 70% of the base salary for full disability, and 50% for partial disability. If the balance in the account is less than the required minimum to finance a total or partial disability benefit, the worker's disability insurance company makes up the difference.
- Survivors' benefits are payable to a widow, a disabled widower and children younger than age 18 (age 24 if a student and no age limit if disabled). In some cases, parents of the deceased may receive a survivor benefit. If the balance in the deceased's individual account yields a benefit that is lower than the required amount to finance a survivor pension (70% of the worker's average salary in the last 10 years before death), the deceased's life insurance makes up the difference.

Table 11: A sample of international pension schemes

Country	Scheme	Description	Default insurance
USA	401(k), 403(b), 457 and US Thrift Savings Plan (TSP) plans	The 401(k) is the most widespread type of DC plan, it enables employees and employers to make tax-deferred contributions from their salaries to the plan.	No
New Zealand	KiwiSaver	KiwiSaver is a work-based savings initiative to help long-term saving for retirement.	No
Sweden	Pensions managed by the Swedish Pensions Agency	National public pension consists of an income pension, premium pension and guaranteed pension. A compulsory 18.5% of wages is paid: 16% for the income pension, and 2.5% for the premium pension. Most working Swedes also get an occupational pension from their employer, and many also have a private pension.	No
Chile	Chile Pension System (Sistema Provisional)	A compulsory defined contribution system that provides old-age, disability and survival pensions for workers. Employees contribute 10% of their total salary, plus administration charges and premiums for disability and survivors' insurance.	Yes – Premiums are deducted and contribute to a national disability scheme. The balance of the pension fund is used to purchase a lifetime disability annuity, which is topped up by group life insurance if insufficient.
UK	Auto-enrolment	Compulsory auto-enrolment into a private pension fund at minimal levels (around 0.5%) for workers meeting certain criteria.	No
Canada	Canadian Pension Plan (CPP)	The CPP provides contributors and their families with partial replacement of earnings in the case of retirement, disability or death. It is a compulsory pension plan for individual's over 18 who earn a minimum of $3,500 per year. The contribution rate of 9.9% is split evenly between the individual and the employer, with a minimum and maximum amount.	Yes – Monthly Disability benefit, Survivor's pension, death benefit, children's benefit. This is provided by the government and is a fixed amount.
France		The system provides a safety net for those who have not contributed for health reasons or because they were carers, a mandatory pension funded by social security contributions, a mandatory contribution from salary towards a pension and voluntary contributions.	No

1. http://www.kiwisaver.govt.nz/
2. https://www.pensionsmyndigheten.se/Welcome_en
3. https://www.canada.ca/en/services/benefits/publicpensions/cpp.html
4. http://www.oecd.org/finance/private-pensions/49497472.pdf
5. https://www.ssa.gov/policy/docs/ssb/v68n2/v68n2p69.html

7. Areas for further consideration

In undertaking this review of default group insurance in superannuation, we would like to highlight areas for further consideration that would support the discussion/debate about insurance in superannuation. These include the following key areas.

7.1 Objective of insurance in superannuation

In debating the merit of the current system, an important question to obtain consensus on is *How much insurance is desirable?* The answer to this question can guide the debate in terms of the level of insurance cover we want to encourage people to have.

At KPMG, we suggest a framework as follows. There are four levels of insurance: Basic, Adequate, Comfortable and Over insurance. These are defined as below.

- **Basic insurance:** This level of insurance is designed to cover basic needs such that, upon death, the family is not forced to sell their home or belongings.
- **Adequate insurance:** This level of insurance is designed to cover the family's needs until the children become adult and, if relevant, provide ongoing rental support until the partner retires. The surviving partner is expected to continue to work (or return to work) and to use the deceased superannuation and other assets to supplement the family's future income.
- **Comfortable insurance:** This level of insurance is designed to ensure the family has no change in financial circumstances following death. For example, it might ensure that a non-working parent is not obliged to return to the workforce.
- **Over insurance:** This level of insurance is in excess of the needs created by the Death or disability of an individual.

7.2 Insurance benefit design

The impact on retirement savings for low income earners, young people and females can be somewhat mitigated by having an appropriate benefit design and cessation rule. An appropriate default insurance benefit design is one that takes into account both the members' broad insurance needs and their ability to pay.

- Insurance should vary according to the individual's needs for protection. Insurance needs can vary for different cohorts within superannuation funds and for individuals over time. For example, younger members are likely to have different insurance needs. Default group insurance settings should, where possible, accommodate the different insurance needs of those cohorts. For example, average household debt by age could be considered in order to determine default levels of insurance cover within superannuation.

This would effectively tailor the level of cover provided to individuals of different ages based upon a broad data set of the Australian population. As the information is not dependent on the members supplying it, it can form the basis of a needs-based life-cycle design that can be applicable across many superannuation funds. This could be further tailored based upon a fund's underlying demographic and average salary levels to ensure insurance cover levels meet the needs of each fund's membership base.

- Given that salary is an important driver of benefit erosion, consideration should be given to introducing a premium cap based on the level of SGC, which is in turn linked to salary.
- Introducing appropriate cessation rules can make a significant difference to segments of the membership that require special consideration such as casual workers, females who have a low participation rate in the workforce, or leave and then return to the workforce, particularly in respect of IP cover. The cessation rule for IP needs to be designed from an affordability perspective as well as to protect members from paying for cover that they may not be able to claim upon.
- Consider the rationale and cost of providing both a lump sum and an income replacement on disablement. Are Death, TPD and IP cover all necessary for default group insurance cover or can TPD and IP be interchangeable?
  - Minimise 'windfalls': historically it has been possible for individuals to claim TPD more than once. Sunsuper recently released a report stating that one third of TPD recipients return to work within 2 years of receiving a benefit. In order for TPD to remain affordable for members and to achieve the stated purpose, the product design may need to be updated to prevent a lump sum being paid for TPD, to members who later return to work, and therefore arguably did not need such a generous payment. An option is to consider paying a TPD benefit in stages (such as that used by Sunsuper and Catholic Super) or in the form of an income stream rather than a lump sum, one off payment.

A Data sources

A.1 Input data used

A.1.1 Funds included in analysis

The model is based on membership data of 12 superannuation funds. They are selected to represent a reasonably large proportion of the default superannuation accounts with insurance (76%). The selected funds (in alphabetical order) are:

- AustralianSuper
- Care Super
- Construction & Building Unions Superannuation (CBUS)
- First State Superannuation Scheme
- Health Employees Superannuation Trust Australia (HESTA)
- HOSTPLUS Superannuation Fund
- MTAA Superannuation Fund
- Public Sector Superannuation Accumulation Plan (PSSAP)
- Retail Employees Superannuation Trust (REST)
- State Public Sector Superannuation Scheme (QSuper)
- Sunsuper Superannuation Fund
- Victorian Superannuation Fund (VicSuper).

Tax sample file

A 2014 tax sample file of 258,774 individual records was used to estimate an average superannuation balance and salary by age, gender and income. It is noted that this information relates to people who have a tax file number. This means that, if a member does not earn enough to have a tax file number or has not submitted their tax return, they are not included.

We recognise this bias and note that if data was available to correct this bias, it is possible that the impact on certain members with low incomes may be even greater than stated in this report.

APRA superannuation data

APRA provides publicly available information on APRA regulated superannuation funds at 30 June 2016. The data is provided at the account level. The data includes:

- total number of members and total account balance in the fund
- number of members with insurance cover, split by Death, TPD and IP
- number of member accounts without insurance due to member opt-out
- number of accounts and balance split by gender
- age profile of members by gender, number of accounts and balance.

This data file was used to obtain information on the total number of accounts in each superannuation fund by age and gender, the proportion of accounts with Death, TPD and IP insurance and the average account balance.

Default insurance premium data

Details of the default group insurance benefit and associated premium rates by age for Death, TPD and IP were collected for each superannuation fund.

Sample member file or model point file

A file containing 1,200 model points was created as an input file to the projection. The Model Point File includes the 12 superannuation funds mentioned previously, with each model point representing a cohort of accounts based on the superannuation fund, age, gender and income band of the member. Average account balance, average income, and the total number of accounts in each cohort were overlayed from the Tax Sample File and APRA statistics.

B Projection model

B.1 Methodology

The model is based on a deterministic projection that takes a snapshot of the population and projects it into the future using best estimate assumptions. Each member's account balance increases with investment returns and guaranteed superannuation contributions, and reduces with insurance premium deductions and exits due to Death and TPD. For simplicity, no allowance has been made for new entrants into the system (for example young people entering the workforce, migration, or individuals returning to work who were not captured in the snapshot).

Other simplifications in modelling include:

- No allowance for future changes in workforce participation, for example breaks in employment, or transitions from full to part-time employment. Changes in workforce participation would impact the member's contributions, but typically insurance premiums would continue to be deducted.
- The current premiums and benefit amounts are applied throughout the projection. We note that future premium increases may be necessary to allow for the ageing workforce.
- No allowance for members switching between superannuation funds in the future has been made. There is a wide range of default group insurance benefits and premiums by superannuation fund, so member switching would impact the total level of coverage and premiums paid.
- No allowance for changes to insurance cover has been made. The model assumes that members maintain default group insurance cover for the full projection period.
- Limited features. As the model is intended only for comparison purposes, it does not incorporate all of the features of the superannuation system such as co-payments, voluntary contributions or administration fees.
- Account duplication is static. The modelling has been performed at the account level, with accounts added together to obtain an estimate of the impact at the member level. Data from the ATO indicates that, at 30 June 2016, approximately 43% of people had more than one superannuation account[34]. The approach implicitly assumes that the level of duplication is constant throughout the projection, i.e. no member opens a new account or consolidates an existing account.

[34] Superannuation accounts data overview, ATO, 15 Aug 2016, https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Super-statistics/Super-accounts-data/Super-accounts-data-overview/

- Participation rate is static. No allowance was made for potential future changes to participation rates in the workforce by females or males.
- Uniform investment earnings. No allowance is made for different investment profiles.
- Cessation rules are modelled approximately. No cessation limit applies to the active superannuation account and a $3,000 limit applies to the duplicate accounts. In reality, 6 of the 12 superannuation funds have cessation limits for Death cover, 2 funds cease premium deductions after contributions stop for 12 months and for the other 4 superannuation funds, premiums are deducted until the account balance runs out.

B.2 Inputs and assumptions

Sample member file or model point file

The main input into the projection model is a model point file of the members of the 12 superannuation funds, with each sample member or model point representing a cohort of members of the same gender, age band, salary level, total account balance (across all superannuation accounts), fund and with the same number of superannuation accounts. A weighting is assigned to each sample member or model point based on the assumed distribution derived from APRA and ATO statistics.

Assumptions

The key assumptions used in the projection.

- Investment earnings of 4.5%, net of tax and investment fees.
- Wage inflation of 2.0%.
- SGC rates of 9.5% currently stepping up to 12% at 2025-2026 as per the following table.

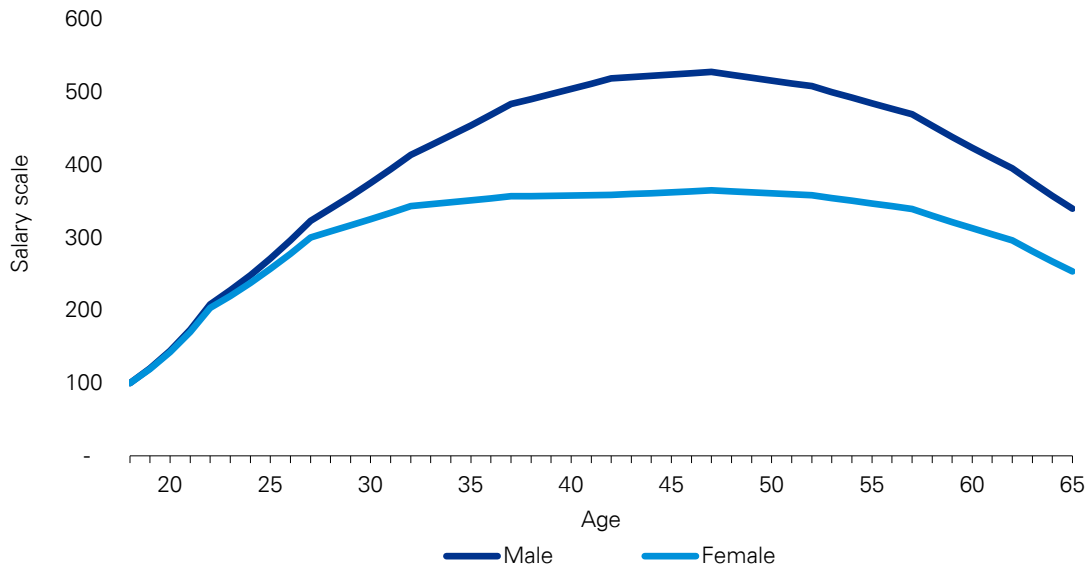
Fiscal Year	SGC Rates
2015–16	9.50%
2016–17	9.50%
2017–18	9.50%
2018–19	9.50%
2019–20	9.50%
2020–21	9.50%
2021–22	10.00%
2022–23	10.50%
2023-24	11.00%
2024-25	11.50%
2025-26	12.00%

- For public sector superannuation funds, where the actual contribution rates were higher than the SGC rate, these were used instead. These are shown in the following table:

Public Sector Funds	Contribution Rates
Public Sector Superannuation Accumulation Plan[35]	15.40%
State Public Sector Superannuation Scheme[36]	12.75%
Victorian Superannuation Fund[37]	10.00%

- For the purposes of this modelling, we have not applied the maximum superannuation contribution base (MSCB) used to determine the maximum SGC that an employer is required to make under superannuation legislation. The maximum superannuation contribution base for the 2017/2018 year is $52,760 per quarter (entitlement is assessed quarterly), or the equivalent of $211,040 annually. The impact is to slightly overstate the SGC.
- Contributions tax rate of 15%.
- Insurance premium tax rebate of 15% (assumes each superannuation fund generates enough income to offset the premium rebate).
- A salary scale is constructed based on the ATO data for males and females as shown in Figure 29. This scale shows how salary will be increase over time as a person progresses in their career.

Figure 29: Salary Scale



Insurance premiums

Insurance premiums are sourced from each of the superannuation funds' PDS and websites, as at 30 June 2016.

[35] http://www.pssap.gov.au/storage/PSSap_shortform_PDS_131129_web.pdf
[36] https://qsuper.qld.gov.au/~/media/PDFs/QSuper-public/Publications/ib29.ashx
[37] https://www.vicsuper.com.au/~/media/files/pdfs-and-downloads/member-publications/v205-insurance-handbook.pdf

C Cameos

C.1 Cameo 1: Sarah

Sarah is 23 years old and is in her final year of her Bachelor of Pharmacy. She has been a tutor at university and working on a part-time basis at Woolworths to support herself financially throughout her studies.

Sarah has just secured a graduate position as a trainee pharmacist and will begin her new job next year with a starting salary of $50,000 per year. She currently earns $25,000 per year.

Sarah currently has $7,500 in superannuation savings, split approximately evenly between Fund A and Fund B. Upon starting her new job, Sarah did not elect choice of fund. As a result, an account is opened on her behalf with her employer's default fund, Fund C, and is automatically invested in the default MySuper option (a balanced investment product).

When Sarah joins Fund C, she has the following default group insurance cover across the three funds:

Fund	Death	TPD	IP per month (benefit period)
A	$47,600	$47,600	$2,500 (2 years)
B	$154,500	$68,000	$1,550 (to age 60)
C	$170,000	-	$850 (to age 67)
Total	**$372,100**	**$115,600**	**$4,900**

Sarah has total IP cover of $4,900 per month, but if she is unable to work due to sickness or injury, the overall benefit will be restricted to 75% of her pre-disability income, equal to 75% of $50,000/12 = $3,125 per month.

Going forward, Sarah directs all her employer SGC throughout her working life to Fund C. No further contributions are made into her superannuation accounts held with Fund A and Fund B, however, Sarah does not cancel her insurance cover with her previous funds. Therefore, insurance premiums continue to be deducted from her accounts until the insurance cancels in line with each fund's cessation rules as follows.

- Fund A: Lump sum insurance cancels when the account balance falls below $3,000 at age 42 and IP cover cancels after 12 months of the fund not receiving contributions (at age 24).
- Fund B: All insurance cancels when the account balance falls below $3,000 at age 29.

Upon retirement at age 65, Sarah's total retirement balance is estimated to be $1,000,137. The impact of insurance premium deductions is set out in the following table:

Fund	Expected superannuation balance (with default insurance)	Expected superannuation balance (with no default insurance)	Impact of insurance on superannuation balance
A	$8,173	$21,747	$13,573 (62%)
B	$14,736	$24,853	$10,118 (41%)
C	$977,228	$1,016,215	$38,988 (4%)
Total	**$1,000,137**	**$1,062,816**	**$62,679 (6%)**

Assumptions:

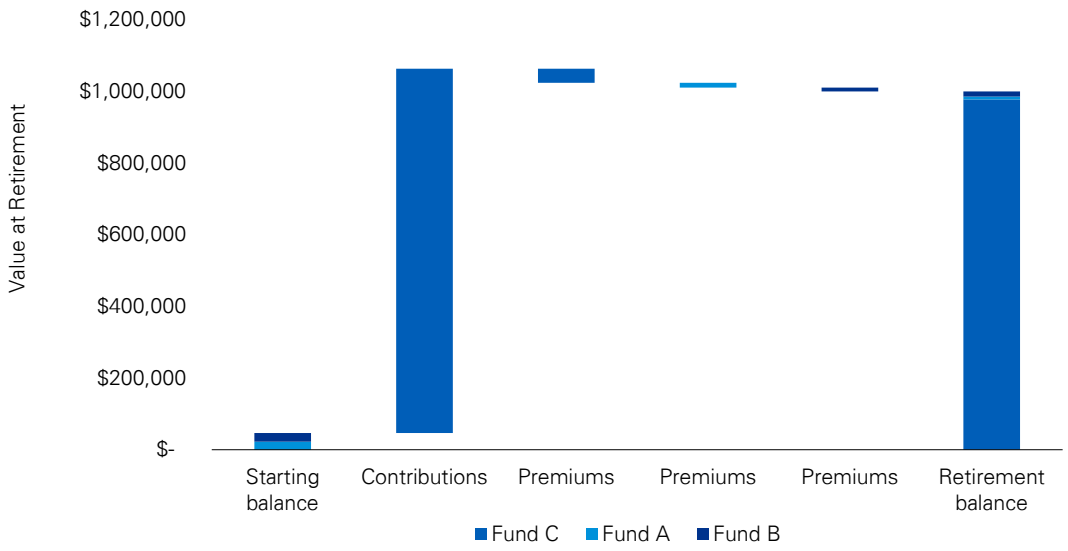
*An investment earning rate of 4.5% per year (net of tax and fees) over the period

*SGC rate increases in line with legislation

*Promotional salary scale and constant wage inflation of 2.0% per year over the period

Note:

*The vertical axis represents the accumulated value at retirement of premiums, contributions, and retirement savings. Investment income is implicitly included in each of these items. This presentation is used consistently thorough out the 6 cameos.



Had Sarah's salary been $22,000 instead of $50,000 and remained low over her career, her premium deduction would have been unchanged, but her retirement balance would have been lower by $568,906, which means her insurance deduction would have represented 13% of her retirement savings.

C.2 Cameo 2: Bob

Bob is 45 years old and is a public service employee. He is currently earning $100,000 per year and over his career, has accumulated $175,000 of superannuation savings, held in Fund X.

By his own initiative, Bob recently opened an account with Fund Y and directed his employer to pay all future contributions to this fund. As Bob opened the account with Fund Y, he has the following default group insurance cover across the two funds:

Fund	Death	TPD	IP per month (benefit period)
X	$325,000	$162,500	$6,250 (5 years)
Y	$104,800	$26,200	$2,500 (2 years)
Total	**$429,800**	**$188,700**	**$8,750**

75% of salary, however cover is fixed after Bob makes no further contributions to Fund X.

Bob has total IP cover of $8,750 per month, but if he is unable to work due to sickness or injury, the overall benefit will be restricted to 75% of his pre-disability income, equal to 75% of $100,000/12 = $6,250 per month.

Bob chooses not to consolidate his two superannuation fund accounts and he does not cancel his insurance cover with Fund X. Insurance premiums continue to be deducted from his accounts and due to his large balance, the insurance cover will not cancel until the normal cover expiry age of 65.

At age 55, Bob suffers a heart attack with resulting complications. His doctors advise him not to return to work. Bob finds himself in a situation where he is no longer able to earn an income and decides to make a claim on his IP benefits. His benefits are restricted to 75% of his pre-disability income. Bob's salary had increased to $123,000 by the time of his heart attack. Bob's health does not improve enough for him to return to work.

Bob's insurance benefit payments are summarised in the following table:

	Fund X	Fund Y	Total
Sum Insured (per month)	$6,250	$2,500	$8,750
Benefit Period	5 years	2 years	
75% of Monthly Pre-Disability Income		$7,688	
Benefit Payments First 2 Years	Combined limited to $7,688 per month x 24 = $184,500		
Benefit Payments Next 3 Years	$6,250 x 36 = $225,000	No cover	$225,000
Total Benefit Payments		$409,500	

No IP premiums are deducted from the time of Bob's claim, however, Death and TPD premiums continue to be deducted until the normal cover expiry age of 65.

Upon reaching age 65, Bob's total superannuation account balance is estimated to be $535,102. The impact of insurance premium deductions are set out in the following table:

Fund	Expected superannuation balance (with default insurance)	Expected superannuation balance (with no default insurance)	Impact of insurance on superannuation balance
X	$371,580	$412,863	$41,283 (10%)
Y	$163,522	$175,980	$12,458 (7%)
Total	**$535,102**	**$588,843**	**$53,741 (9%)**

Assumptions:

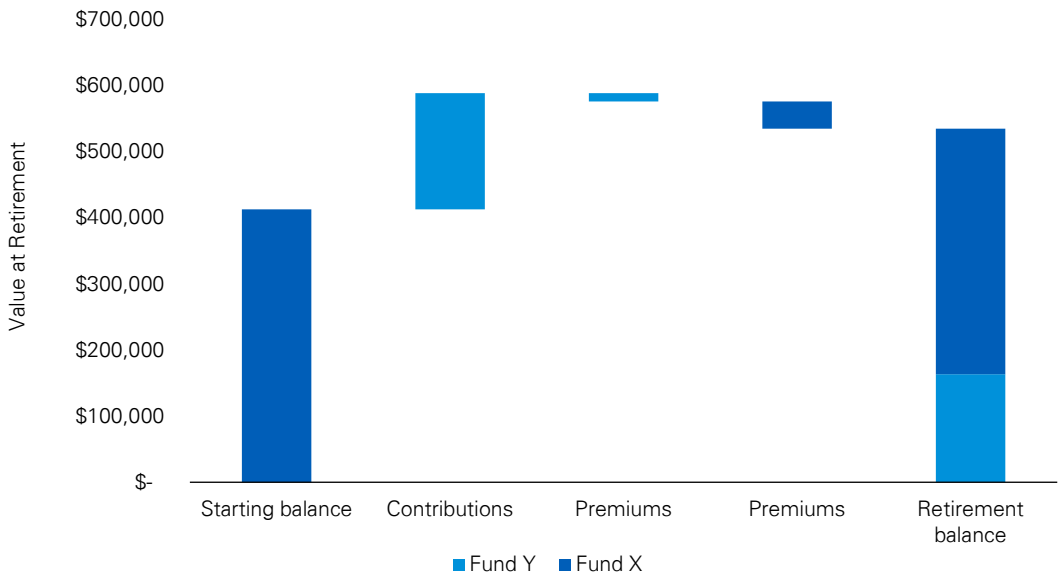
*An investment earning rate of 4.5% per year (net of tax and fees) over the period

*SGC rate increases in line with legislation

*Promotional salary scale and constant wage inflation of 2.0% per year over the period

Alternative scenario

If Bob had consolidated his Fund X account into Fund Y, he would only have been able to claim IP benefits from Fund Y, as summarised in the following table:



	Fund Y
Sum Insured (per month)	$2,500
Benefit Period	2 years
75% of Monthly Pre-Disability Income	$7,688
Benefit Payments First 2 Years	$2,500 per month x 24 = $60,000
Benefit Payments Next 3 Years	No cover
Total Benefit Payments	**$60,000**

Bob is disappointed by the level of IP cover provided by Fund Y as he expected the benefits to be comparable to those of Fund X. Bob did not realise that Fund Y had a much lower level of default group insurance cover.

Upon reaching age 65, Bob's total superannuation balance is estimated to be $576,384, which is $41,283 more than he would have received under the base case (not consolidating Fund X into Fund Y), due to not paying insurance premiums to Fund X (the impact of the removal of duplicate administration fees has been ignored).

Under the base case, Bob's account balance was reduced by $53,741 (9%) due to insurance premiums, but in return, Bob had received a total of $409,500 in IP benefits before tax. If Bob has a family with dependent children and 5 years of mortgage[38] repayments remaining on his house (assuming Bob started a mortgage at age 40), the IP benefit payment is sufficient for Bob to continue to make his mortgage payment of $2,480 per month over the next 5 years, while still meeting his family's daily living expenses, so that when he retires, his house is debt free.

C.3 Cameo 3: John

John is 18 years old and has been employed as an apprentice chef in a small family owned restaurant for less than a year. John has aspirations to own a restaurant one day.

John currently earns $10,000 per year and has $500 in superannuation savings.

John's superannuation is held in Fund A, a fund he chose and he directs all employer contributions to this fund throughout his career. Fund A provides the following default group insurance cover for an 18 year old:

Fund	Death	TPD	IP per month (benefit period)
A	$28,273	$56,546	-

John doesn't make a big break in his career and remains employed as a chef at the family owned restaurant throughout his career, with minimal progression in his salary.

Upon retirement at age 65, John's total retirement balance is estimated to be $151,351. The impact of insurance premium deductions is set out in the following table:

Fund	Expected superannuation balance (with default insurance)	Expected superannuation balance (with no default insurance)	Impact of insurance on superannuation balance
A	$151,351	$178,801	$27,449 (15%)

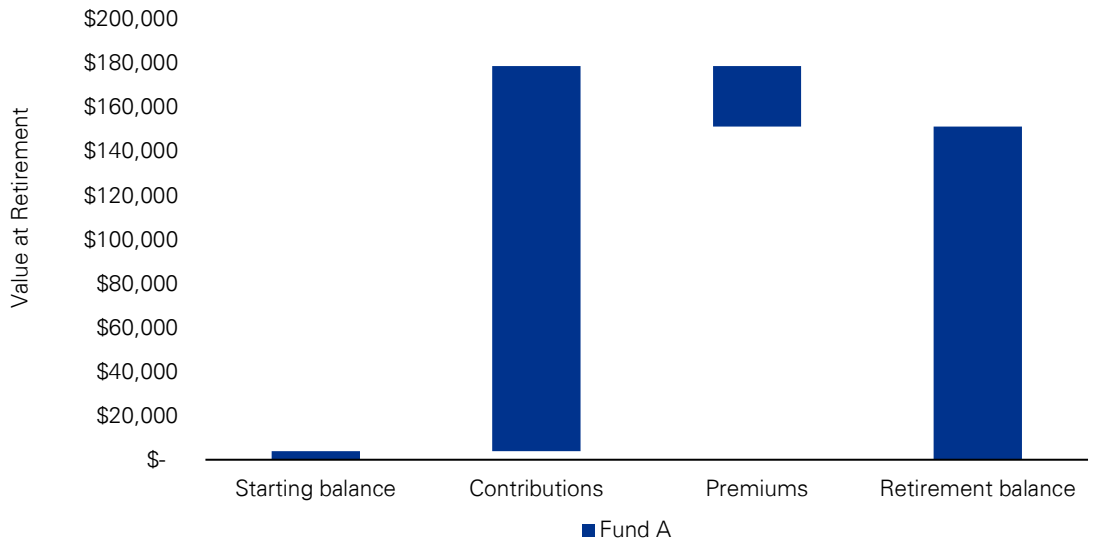
Assumptions:

*An investment earning rate of 4.5% per year (net of tax and fees) over the period

*SGC rate increases in line with legislation

*Promotional salary scale and constant wage inflation of 2.0% per year over the period

[38] Based on an average mortgage of $367,700 and an interest rate of 5.25%, May 2017. Mortgage payment of $2,480 per month and a 20 year principal and interest.



Alternative scenario

John never elected his own superannuation fund and instead all his employer contributions are paid to his employer's default fund, Fund B, which has higher default group insurance cover than Fund A throughout his career. Fund B provides the following default group insurance cover for an 18 year old:

Fund	Death	TPD	IP per month (benefit period)
B	$150,000	$75,000	$756 (2 years)

As a result of the higher insurance premiums over his career, John's total retirement balance under this scenario is estimated to be $117,542 which is a 34% reduction compared to John's retirement savings if there was no insurance in place.

C.4 Cameo 4: Lisa

Lisa is 28 years old and works as a primary school teacher. After working as a substitute teacher over the past 3 years, she is excited to have secured her first full-time permanent teaching position.

Lisa currently earns $45,000 per year and has $4,500 in superannuation savings.

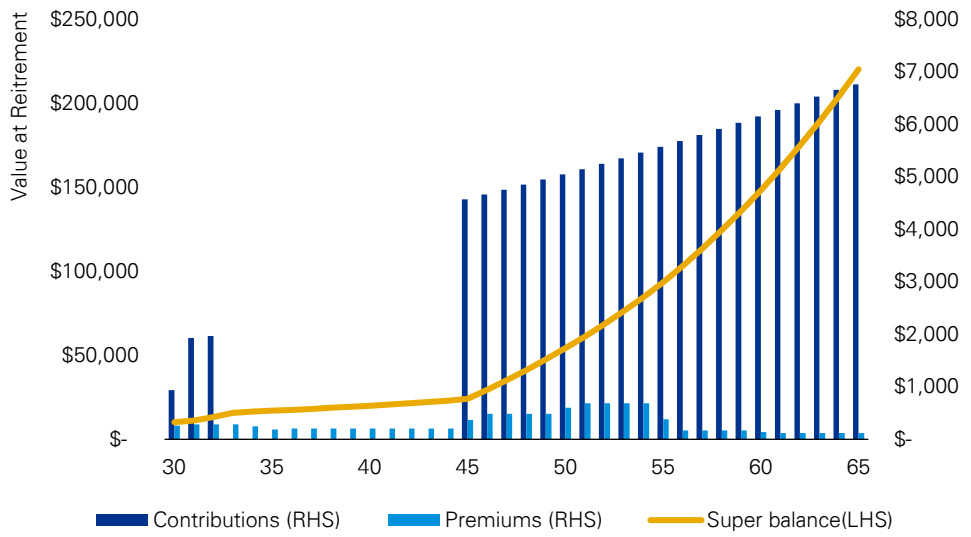
At age 30, Lisa has her first child and goes on maternity leave for 1 year (3 months paid). She returns to work on a part-time basis and has her second child at age 33. Lisa decides to stay at home until both her children are in high-school. At age 45, Lisa returns to work on a full-time basis, however, has to accept a lower salary than if she had not taken a career break.

Lisa's superannuation is held in Fund X, her employer's default superannuation fund. At age 30, when Lisa goes on maternity leave for her first child, she has an account balance of $10,189 and the following default group insurance cover:

Fund	Death	TPD	IP per month (benefit period)
X	$166,800	$55,600	$2,500 (2 years)

Lisa does not make any superannuation contributions after leaving work at age 33. Her IP cover cancels after 12 months of the fund not receiving any contributions. This means that Lisa is not charged premiums for a benefit she could not claim given that she is not working. Fund X also cancels lump sum insurance cover when her account balance falls below $3,000, however, this does not occur. Lisa's IP cover resumes at age 45 when her employer starts contributing to her fund.

The following graph illustrates the progression of Lisa's account balance, increased by contributions and decreased by insurance premiums.



Upon retirement at age 65, Lisa's total retirement balance is estimated to be $220,092. The impact of insurance premium deductions is set out in the following table:

Fund	Expected superannuation balance (with default insurance)	Expected superannuation balance (with no default insurance)	Impact of insurance on superannuation balance
X	$220,092	$246,711	$26,619 (11%)

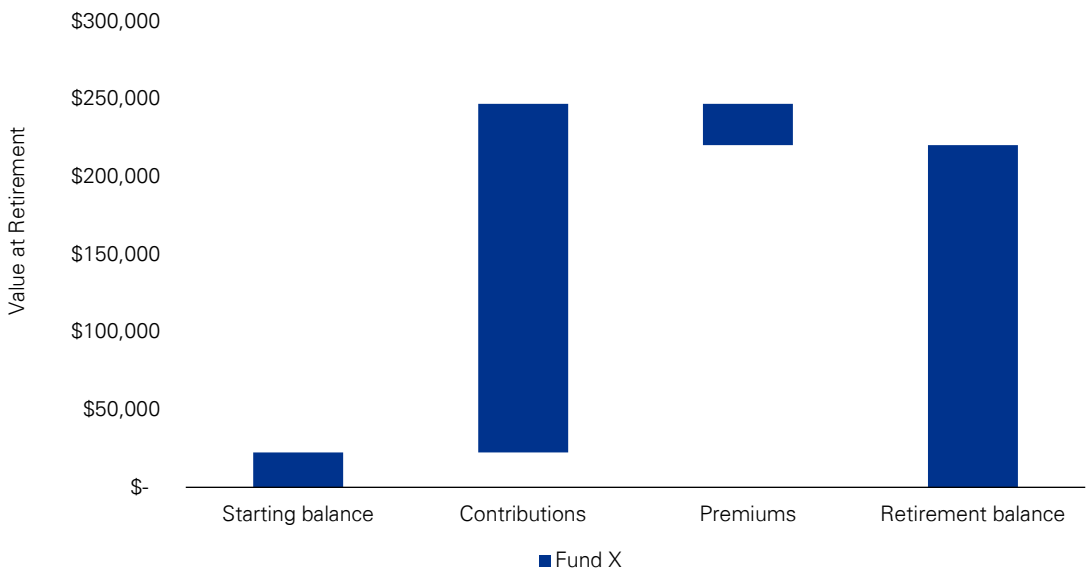
Assumptions:

*An investment earning rate of 4.5% per year (net of tax and fees) over the period

*SGC rate increases in line with legislation

*Promotional salary scale and constant wage inflation of 2.0% per year over the period, other than between age 40 and 45

*Lisa earns half her normal salary whilst working part time between age 30 and 33.



In Lisa's case, the design of the fund's cover and cessation rule has made a significant difference to her retirement savings. Had the cessation rules not been in place, the level of erosion for Lisa would have been 13%.

C.5 Cameo 5: Leon

Leon is 40 years old, married with two young children and is employed as a manager at a retail store.

Leon currently earns $80,000 per year and has accumulated $75,000 in superannuation savings. His superannuation balance is held in Fund X, his employer's default superannuation fund, and invested in the default MySuper option. Fund X provides the following default group insurance cover for a 40 year old:

Fund	Death	TPD	IP per month (benefit period)
X	$377,500	$68,000	$2,400 (to age 60)

Leon is involved in a car accident at age 45 and is paralysed. He is subsequently declared totally and permanently disabled and makes an insurance claim on his TPD cover. Leon also withdraws his superannuation account balance from the fund under the TPD condition of release.

A lump sum benefit of $197,491 is paid to Leon. The impact of Leon's insurance cover is illustrated in the following table:

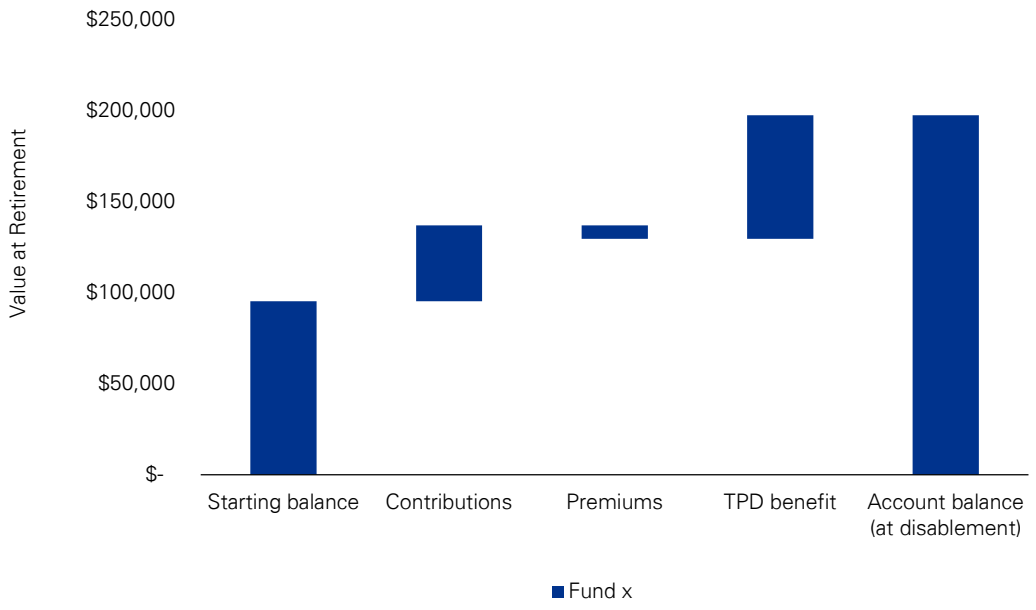
Component	Amount
Starting balance and interest	$95,194
Value of future contributions	$41,735
Account balance at age 45 with no insurance	$136,928
Cost of insurance premiums	($7,437)
TPD lump sum benefit	$68,000
Total benefit at age 45 with insurance	**$197,491**

Assumptions:

*An investment earning rate of 4.5% per year (net of tax and fees) over the period

*SGC rate increases in line with legislation

*Promotional salary scale and constant wage inflation of 2.0% per year over the period



With these extra funds, Leon can make alterations to his house to help him adjust to his new conditions and continue to pay his mortgage payments without putting any burden on his wife's income.

Additionally, Leon's wife can also continue to work and make an ongoing contribution to society, given Leon is able to afford a carer as a result of his TPD payment, in order to maintain his day-to-day activities whilst his wife is at work.

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