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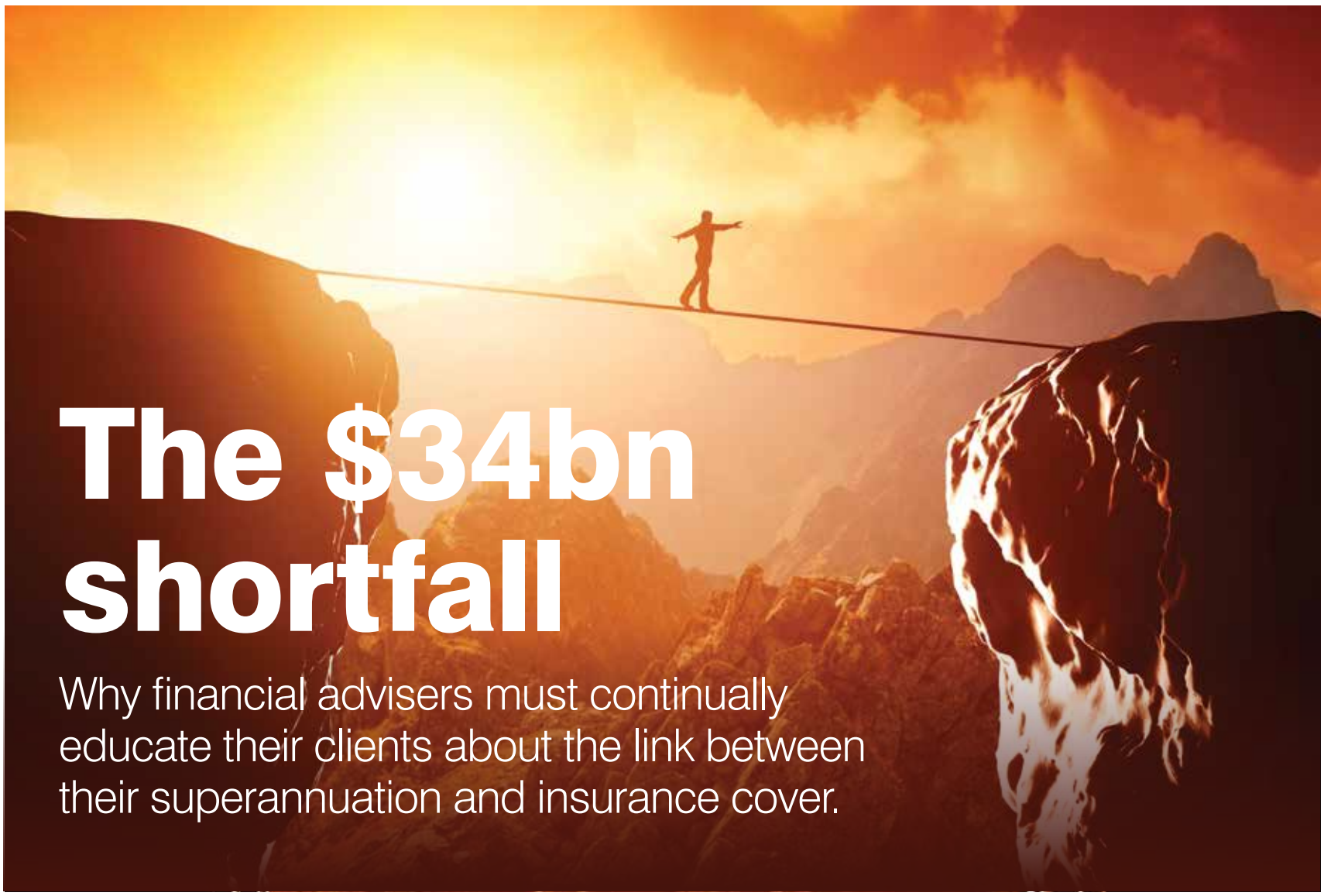

The $34bn shortfall

Why financial advisers must continually educate their clients about the link between their superannuation and insurance cover.

Ally Selby

The government's early release of superannuation scheme, introduced earlier this year and extended until 31 December 2020, has assisted millions of Australians in weathering the economic effects of the COVID-19 crisis.

Since the scheme's inception in April, more than $34 billion has been paid out to members, with industry funds AustralianSuper, Sunsuper, Rest, Hostplus and Cbus coughing up the lion's share of payouts to members.

"The early release of superannuation initiative has been very well received by Australians impacted by COVID-19," Senator Jane Hume[01] told *Financial Standard*.

"Almost 2.9 million members took up the option of withdrawing some of their savings, and letters and calls to my office tell me it has been a lifeline for many."

However, for those with already low balances – and especially those that withdrew their retirement savings completely – a safety net, of sorts, may have been inadvertently impacted in the process too.

Super funds - although research reveals that some Australians may not know it - provide default insurance cover to their members, with fees withdrawn automatically from accounts and claims paid out when the unexpected occurs.

Over the past year and a half, two key pieces of legislation have been introduced with direct impact on insurance inside super; the Protecting Your Super Package (PYSP) and the Putting Members' Interests First (PMIF) legislation, effective from 1 July 2019 and April 1 this year, respectively.

The reforms aim to protect member's retirement savings – particularly those that are already low to begin with or those with multiple accounts - from being eroded by excessive fees and the costs of insurance cover that members may not need or want.

The changes resulted in the automatic cancellation of default insurance arrangements for people under 25, as well as for members with account balances less than $6000 on April 1 this year, unless they opted otherwise.

Since November 2019, the reforms have resulted in $2.9 billion of inactive savings consolidated into the active accounts of 1.4 million people, according to the Treasury, saving Australians an estimated $700 million in unnecessary fees and insurance premiums.

Newly released APRA data shows the reforms led to the cancellation of around 4.2 million accounts between 1 May 2019 and April 1 this year.

Hume says the legislation would not impact individuals whose account balances were above $6000 at the cut-off date and then fell below $6000 after accessing early release. However, she notes that rules around insurance could vary fund to fund.

"There must be sufficient balance to pay premiums and additionally, some funds may have their own rules on when insurance is switched off for low or nil balance accounts in line with the insurance covenant under the Superannuation Industry (Supervision) Act 1993, so members need to be aware of the rules of their fund," the Assistant Minister for Superannuation, Financial Services and Financial Technology says.

However, there is no data available on how many accounts have been closed since the inception of ERS on April 20. A spokesperson for APRA said it was planning to make public some data on cancellations towards the end of November.

$34bn

The amount removed from the super system as at October 16.

Hostplus group executive of member experience Paul Watson[02] says the early withdrawal of super can have a direct impact on insurance cover, particularly in the case where that withdrawal is likely to substantially reduce a member's balance or result in their account being closed.

"This is especially so where an account balance reaches $0 due to a full withdrawal of retirement savings, in which case typically the member's account will be closed, and any insurance cover will cease," he explains.

Over 305,000 Hostplus members have applied for the government's early release scheme, representing 24% of the industry super fund's total members.

"Sadly, of these members, 39,000 have had their Hostplus account closed, as their early release payment represented their entire account balance," Watson says.

Hostplus members whose balances fell below $6000 due to poor investment performance, fees, or early release after April 1 would not have automatically lost their insurance cover, he says.

However, "premiums will generally continue to be deducted from members' accounts on a regular basis, which, unless their accounts are increasing due to contributions and investment returns exceeding the cost of administration, investment and insurance costs, will likely further reduce their account balances as a result," Watson says.

Similarly, Cbus chief executive Justin Arter explained during a hearing to the House of Representatives Standing Committee on Economics in September that the government's ERS had adversely impacted some of the fund's members.

01:
Jane Hume
assistant minister, superannuation and financial services

02:
Paul Watson
group executive, member experience Hostplus

03:
Chesne Stafford
chief customer and marketing officer MetLife

Since the inception of ERS, the industry super fund has paid out more than $2.16 billion to more than 261,000 members facing financial hardship during the COVID-19 crisis.

"However, we remain concerned about the long-term reduction of retirement incomes for members, who have typically withdrawn the full $20,000," Arter said.

During the hearing, Arter noted that members who withdrew their entire balance would no longer receive TPD insurance with their account. This is particularly detrimental for Cbus members as TPD can be both expensive and in some cases unobtainable for construction workers, he said.

"The reason it is unobtainable at any price is that typically our workers are working at heights in dangerous occupations, and many of them are wondering whether they will go home alive at night," he said.

"As you can imagine, being able to obtain that insurance at a reasonable price is an essential part of our offer."

But when members drain their accounts to zero, that coverage goes away too, he said.

"We're very anxious that they do maintain a balance with us," Arter said.

Financial adviser and founder of Master Your Money Now Chris Carlin has also seen some clients risk their insurance cover after dropping below $6000 or withdrawing due to COVID-19.

"They are not aware of the legislation which means if their balance does drop below this level they are at risk of losing their personal insurance cover, especially if there are no ongoing contributions going into the fund," he says.

Insurance cover may cease on a member's account if there are insufficient funds to pay for premiums, or if a contribution has not been received for sixteen consecutive months or more.

Pivot Wealth founder and financial adviser Ben Nash believes that a significant number of Australians would be at risk.

"Unfortunately, there would be a pretty significant number of people that have withdrawn all the money in their super and therefore lost their insurance cover," he says.

Yet, MetLife chief customer and marketing officer Chesne Stafford[03] says it's still too early to tell whether these account closures have had an impact on insurance.

"While there is data about how much has been withdrawn from superannuation in total, we don't know how many people have dropped below the balance thresholds applicable at each fund to retain insurance coverage, or have reduced their account balance to zero," she says.

"Additionally, we are yet to see how many people may have fallen below the threshold but opted in to continue their insurance coverage."

While Stafford noted that MetLife saw a lift in claim applications at the beginning of the crisis, she said she couldn't "directly pinpoint whether that was related to COVID or to the legislation, as they both happened at the same time".

"Based on what we are hearing and what we are seeing and what our super funds are saying, we are not expecting a discernible impact on overall insurance flows," she says.

Super funds typically provide two types of insurance to members, including life insurance, paid out to beneficiaries in the case of a member's death) and total and permanent disablement (TPD) insurance, paid out if a member cannot work again. They may also provide members with income protection (IP) and terminal illness cover.

"For most Australians, the insurance cover they have within their super is generally the only life or disability insurance cover they have," Watson says.

"If an unexpected event happens, such as an illness, injury or death, having the right insurance can help ensure they or their family's lifestyle is financially protected, especially when they rely on the income of that person."

Yet, research undertaken by MetLife found that many Australians were unaware that they had insurance cover at all.

"Around 73% of Australians are aware that they have insurance inside super, however only half of them know the specific level of cover they have and then even less know that they can adjust and change that level of cover," Stafford says.

Research undertaken by Hostplus uncovered similar results.

"A survey of Hostplus members last year found that 87% of members were aware that insurance was generally provided as part of super arrangements, however, 41% of members weren't aware that they themselves had insurance as part of their Hostplus membership," Watson says.

For member's whose accounts are closed as a result of ERS or the PYSP and PMIF reforms, getting the same insurance cover they had previously is not as easy as one may think.

"Even if the person were to establish a new super account, with the same or a different fund, this may not result in the person being able to restore their previous insurance cover, either automatically or if opted-into," Watson says.

The customer may need to undergo health checks or an underwriting process in a bid to get the same coverage back, Stafford adds.

"You need to go through an underwriting process if you want to reinstate that cover and go back through a non-automatic application process on that basis," she says.

As a result, those with health conditions or in dangerous occupations may not be able to receive the same cover.

"I always speak to my clients about the restrictions of personal insurance cover within superannuation, especially nurses who are five times more likely than other occupations to be forced into retirement with a back injury," Carlin says.

One word can make all the difference in a successful TPD claim, he notes.

"If you have TPD cover solely in super the definition to make a successful claim is if you are unable to work in ANY occupation, which means if a nurse does their back, but they can still pick up a phone and work in a call centre, then their TPD cover may not pay out," he explains.

"However, if you hold TPD cover… either under a Superlink arrangement or as a policy held solely in your personal name, the definition can change to OWN occupation, which means if you are unable to work in the occupation you have been trained for i.e. as a registered nurse, then this cover pays out."

Nash noted that a number of his clients choose to maintain multiple super fund accounts to keep their preferred insurance cover in a previous fund.

"Anyone that has a medical history that would preclude them from getting new insurance cover on terms that they are prepared to accept would choose to keep their existing cover," he says.

"Basically, as soon as you have a skin cancer that's above a certain size, any new insurance cover could have a cancer exclusion placed on it."

Similarly, women who receive an abnormal pap test will also face a multiple-year exclusion on cervical cancer, he says.

For those wanting to reapply for insurance following the cancellation of their account (or for those who become eligible after surpassing a $6000 balance), Nash warns that they will also automatically face changes to their disclosure obligations.

"The duty of disclosure requires members to tell the insurance company everything they could reasonably be expected to want to know to assess whether they want to give you an insurance application or not," he explains.

"For the first three years, even if it's inadvertent disclosure, that policy will be considered to never have existed in the first place, as it is in breach of that part of the Insurance Contracts Act."

In addition, pre-existing condition exclusions apply on almost all group policies for a set period of time, Nash says, so cancelling and replacing a policy could result in that period restarting.

Nonetheless, Stafford maintains that insurance inside super will have a particularly important role to play as we emerge from the COVID-19 crisis.

"The fear of getting sick, the fear of potentially being stood down from work, isolation – all of those things are having an impact on mental health," she says.

"For those people who end up in a difficult situation as a result of that, insurance inside superannuation can provide those benefits that they may not have expected they would ever need." **FS**

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