PARLIAMENTARY JOINT COMMITTEE

Inquiry into Life Insurance

ISA AND AIST JOINT SUBMISSION

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ABOUT THE AUSTRALIAN INSTITUTE OF SUPERANNUATION TRUSTEES AND INDUSTRY SUPER AUSTRALIA

The Australian Institute of Superannuation Trustees is a national not-for-profit organisation whose membership consists of the trustee directors and staff of industry, corporate and public-sector funds.

As the principal advocate and peak representative body for the $650 billion not-for-profit superannuation sector, AIST plays a key role in policy development and is a leading provider of research.

AIST provides professional training, consulting services and support for trustees and fund staff to help them meet the challenges of managing superannuation funds and advancing the interests of their fund members. Each year, AIST hosts the Conference of Major Superannuation Funds (CMSF), in addition to numerous other industry conferences and events.

Industry Super Australia (ISA) manages collective projects on behalf of Industry SuperFunds with the objective of maximising the retirement savings of five million industry super members. These projects include research, policy development, government relations and advocacy as well as the well-known Industry SuperFunds Joint Marketing Campaign.

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INQUIRY INTO LIFE INSURANCE

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INQUIRY INTO LIFE INSURANCE

Introduction

Insurance is provided within superannuation because policy makers and trustees believe that the forms of insurance offered within superannuation provide an overwhelming benefit to superannuation fund members and is in the public interest. Superannuation trustees are vigilant in working to ensure that the cost of the insurance they provide does not inappropriately erode the retirement income of beneficiaries and that the type of cover they provide is appropriate. If the purpose of superannuation is to provide income in retirement that supplements or replaces the Age Pension then, the insurance within superannuation is to provide members with protection should they not reach retirement due to illness, injury or death.

The provision of insurance to millions of working Australians has been a central design feature of the Australian superannuation system backed by public policy considerations and regulation. The Australian superannuation system has been built to support Australians in retirement and to support annually those tens of thousands who were unfortunate enough through illness, injury or death to not have a working career through to retirement.

ISA and AIST represent 8 million superannuation fund members who are members of not-for-profit superannuation funds. Not-for-profit funds operate for and on behalf of the interests of their members, not shareholders. The funds we collectively represent offer insurance, not purely because legislation requires them to do so, but because they believe doing so is in the best interests of their members. The cover provided also delivers substantial benefits to the community at large and the Australian economy. ISA and AIST are working with the superannuation and insurance industries to further improve the insurance experience of members, but there is more to do. We welcome this inquiry and others that shed light on the industry and the need for change, including the need to remove conflicted remuneration models and the approval by ASIC of enforceable codes of conduct/practice for the industry.

Why insurance is a default requirement within compulsory superannuation

There are a number of examples where society has deemed that some form of compulsory insurance is in the public interest. This includes health insurance via the Medicare levy and behavioural nudges to private health insurance, compulsory personal injury insurance for work related and vehicle related injuries and various forms of group insurance including levies on landowners.

The same public policy considerations have seen insurance products packaged within compulsory superannuation on an opt-out basis. Superannuation is a form of protection that applies to an employee's retirement years and as such insurance arrangements fit comfortably within the framework of superannuation. Insurance within superannuation covers the most important asset many members of not-for-profit funds have – themselves.

Levels of insurance within superannuation

Australians pay in excess of $14 billion annually to life insurance companies. Half, or approximately $7 billion, of these payments are paid from the superannuation accounts of Australians; of which $5 billion are paid from group insurance arrangements within superannuation.

These are significant amounts and continue to grow as Australia's superannuation pool increases and Australians, particularly those with higher account balances, become more engaged with their superannuation accounts and insurance needs. This has significantly reduced Australia's underinsurance problem and has reduced the burden that would in many cases be met by the taxpayer. Notwithstanding the growth in insurance levels, underinsurance in Australia continues to be a problem.

Underinsurance in Australia

Rice Warner's 2015 *Research Report Underinsurance in Australia* found that whilst 61 per cent of Australians have Total Permanent and Death (TPD) insurance, only 21 per cent of Australians have the level of TPD cover required which equates to an underinsurance level of $10,870 billion.[1] The report also found that most of the working population's basic life insurance needs are not being adequately addressed with underinsurance levels of $471 billion for basic coverage and $3,436 billion for income replacement coverage.[2]

The Report also found that the underinsurance for income protection cover was in excess of $610 billion. Furthermore, the Report states that although 40 per cent of Australians have some form of income protection insurance, the average level of protection only covers 30 per cent of needs.[3]

The Rice Warner report finds that the levels of underinsurance are highest amongst working families with children, with default levels of insurance within superannuation covering only 50 per cent of basic death cover needs for families. The report observes that at the other end of the spectrum younger members without children are potentially over insured. These observations are a good example of the care trustees must take when setting default levels of insurance for their members. These settings are particularly important as it is estimated that over 90 per cent of superannuation fund members do not alter the default insurance settings established by their fund.[4]

Economists from the National Centre for Social and Economic Modelling at the University of Canberra[5] have estimated that:

> *"Over the average 45- year working life, 1,061,100 people will be impacted by the death of a parent or a serious illness. That means more than one in five of the 4.5 current working age parents will be impacted during their working life. The argument for industry-recommended insurance levels[6] could not be stronger."*

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[1] Rice Warner, Research Report: Underinsurance in Australia 2015. Page 19

[2] Ibid Page 18

[3] Ibid Page 20

[4] Ibid

[5] Simon Kelly and Quoc Ngu Vu (National Centre for Social and Economic Modelling, University of Canberra): *The Economic Cost of Underinsurance for a Typical Family*, Journal of Financial Advice, Vol3, Issue 3 2010

[6] With the industry-recommended levels of insurance, the family is able to maintain an income after tax, mortgage repayments and childcare that is at least four- fifths of the previous level.

Superannuation funds have an obligation to ensure that the default insurance levels provided to members are appropriate and that they improve the levels of cover and product design to ensure the offering is appropriately aligned to the needs of their members.

The Rice Warner Research Report finds that the levels of underinsurance in Australia, although high in some areas, have decreased significantly as a result of increases in the level of insurance held by individuals, either directly or through their superannuation funds.[7]

Why not-for-profit superannuation funds offer insurance

Not-for-profit superannuation funds believe the inclusion of life, TPD and in some instances income protection insurance on an opt-out basis is in the best interests of their members. This insurance provides members and their families with a level of comfort that in the event of misfortune there will be rehabilitation services and income support that may not otherwise be available. Not-for-profit superannuation funds do not pay dividends to shareholders and do not operate for the benefit of related entity insurance companies.

Beyond any regulatory requirement to do so, not-for-profit superannuation funds offer insurance within their superannuation product as they believe that this in the best interests of their members to do so. Insurance within superannuation provides a level of security that is either not affordable, is unlikely to be purchased by their members, or is not tailored for the occupation the member works in, if purchased outside of group insurance within superannuation.

More than two thirds of Australian employees rely on default fund arrangements and are not actively engaged with their superannuation fund. Consequently the majority of employees do not alter their default insurance.

The current process by which employees are allocated to a default superannuation fund, when they do not exercise choice of fund, segments the superannuation market by industry and occupation. This in turn enables superannuation funds which have a presence in a particular industry to seek and tailor insurance coverage that best suits the needs of the fund's members. This tailoring considers occupational and demographic variances, for example, the insurance needs within an industry dominated by male full-time high-income earners is likely to differ from a workforce dominated by female, low-paid part-time workers.

In some instances, this provides the only insurance a person could obtain and at reasonable premiums because their occupation would either lead to an insurer declining cover or loading the premiums if they were individually underwritten.

Insurance as a regulatory requirement

When superannuation funds provide insurance cover to their membership, they do so in the context of rigorous regulatory requirements which dictate the trustee's obligations in determining level and scope of cover, selecting and supervising an outsourced provider and managing claims and disputes.

Operating standards[8] require trustees to only provide insurance which is consistent with the conditions of release provided for in Schedule 1 to the Superannuation Industry (Supervision) Regulations 1994 (Cth) (SIS Regulations). The regulations also refine the minimum insurance requirement for default funds and

[7] Rice Warner Opcit Page 21

[8] Regulation 4.07D of the SIS Regulations. These limitations do not apply to members who joined a fund prior to 1 July 2014

MySuper members in regulation 9A of the **Superannuation Guarantee** (Administration) Regulations 1993 (Cth).

The above ensures that funds are required to provide death and permanent incapacity (disability) insurance for MySuper members and must do so on an opt-out basis.[9]

Prudential Standard SPS 250 – Insurance in Superannuation

Prudential Standard SPS 250 provides an obligation on Registrable Superannuation Entities (RSE's) and their Boards to have an Insurance Management Framework (IMF) that ensures that insurance arrangements adequately address the minimum requirements of the Prudential Standard and that the licensee formulates and gives effect to appropriate selection processes for, and due diligence of, insurer and monitor relationships with insurers on an ongoing basis.

Funds review their IMF on an annual basis to ensure it remains relevant to changing market conditions, legislation and the appropriateness to the fund and the needs of its members. Each IMF is audited every three years to ensure it is appropriate and conforms to the Prudential Standard.

Section 52 of the Superannuation Industry (Supervision) Act 1993 (the SIS Act)

The SIS Act imports covenants to be included in the governing rules of registrable superannuation entities where covenants or governing rules giving the same effect are not already included. Section 52(7) imports covenants relation to insurance requirement.

These are:

> (7) The covenants referred to in subsection (1) include the following covenants by each trustee of the entity:
>
> (a) to formulate, review regularly and give effect to an insurance strategy for the benefit of beneficiaries of the entity that includes provisions addressing each of the following matters:
>
> (i) the kinds of insurance that are to be offered to, or acquired for the benefit of, beneficiaries;
>
> (ii) the level, or levels, of insurance cover to be offered to, or acquired for the benefit of, beneficiaries;
>
> (iii) the basis for the decision to offer or acquire insurance of those kinds, with cover at that level or levels, having regard to the demographic composition of the beneficiaries of the entity;
>
> (iv) the method by which the insurer is, or the insurers are, to be determined;
>
> (b) to consider the cost to all beneficiaries of offering or acquiring insurance of a particular kind, or at a particular level;
>
> (c) to only offer or acquire insurance of a particular kind, or at a particular level, if the cost of the insurance does not inappropriately erode the retirement income of beneficiaries;
>
> (d) to do everything that is reasonable to pursue an insurance claim for the benefit of a beneficiary, if the claim has a reasonable prospect of success.

[9] Regulation 9.49 provides that where a trustee is reasonably satisfied that life and TPD insurance for MySuper members cannot be placed with an insurer at a reasonable cost or cannot be obtained, it may be offered on a compulsory basis

It should be noted that section 52(7) (d) was introduced as part of the significant MySuper suite of reforms[10] and have significantly raised the obligations on trustees to make decisions in the best financial interests of members. The new covenants are to be read in conjunction with the raft of new Prudential Standards and Regulatory Guidance which when combined with changes to the Corporations Act and Superannuation legislation provide an appropriately rigorous framework for the provision of insurance within superannuation.

Benefits of Group Insurance

There are clear social and financial benefits from superannuation funds providing group life insurance to a large proportion of the community at a competitive price that generally cannot be matched by retail cover. Superannuation funds provide insurance cover for more than 13.5 million Australians, this is a significant contribution to Australia's insurance needs that would otherwise be filled by the taxpayer.

Rice Warner[11] estimates that the cost to the Australian Government directly flowing from underinsurance to be in the order of $1.5 billion per annum. Life underinsurance accounts for $57 million; TPD underinsurance covering the bulk of the cost at $1,258 million per year and income protection underinsurance is estimated to cost the government $260 million per year.

Using Rice Warner's estimates of insurance needs in Australia, including the cost of TPD and provision for beneficiaries in the event of death; there is little doubt that if it were not for the provision of insurance within superannuation, the levels of underinsurance in Australia would be endemic. The consequential call on the public purse of tens of billions of dollars in additional social security, health, housing and related costs, would be a very significant strain on the combined budgets of the State and Federal Governments.

For superannuation fund members, group insurance provides an opportunity for insurance protection at an affordable cost that would for many, not otherwise be available or affordable.

Cost of Group Insurance – getting the balance right

ISA and AIST member funds recognise the impact of insurance costs on member retirement incomes and the need to balance the benefits derived by insurance against its impact on the net retirement benefits of Australians.

Given the nature of group insurance, superannuation trustees have been constantly balancing the need to achieve the correct settings to ensure the benefits of providing insurance are greater than the cost and to ensure that cover remains appropriate for different cohorts of members.

Not-for-profit superannuation funds are constantly reviewing their insurance offerings, and seeking to maximise the benefits of insurance offerings for their members. Both as a whole and where appropriate, for identifiable sub-sets of its members. These reviews examine the cost of and particulars of insurance offered and what levels of default insurance are appropriate.

Member best interest and insurance

The philosophy driving not-for-profit superannuation funds when making decisions regarding insurance is

[10] *Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Act* 2012

[11] Rice Warner opcit

member best interests. Not-for-profit funds do not have a commercial interest in the provision of insurance products to members and are not conflicted in their decision making. There are no external shareholders to whom profits are paid.

Those superannuation funds that have internalised the provision of insurance through the operating of their own insurance entity have done so after the fund's trustees have determined that doing so is in the best interests of their members.

Funds which outsource their insurance are required to do so via competitive tender processes. Funds maintain internal resources with sufficient expertise and experience to enable in-house assessment and benchmarking of the insurers' terms with assistance from external insurance experts engaged by the fund, as required. Furthermore, as part of outsourcing, robust vendor management practices are applied to monitor the insurer on an ongoing basis.

Furthermore, as part of the arrangements with the insurer, rehabilitation and mental health support programs are available to members to get them back to the workforce; provide benefits to the community, and economy and reduce government burden in terms of drain on health system and government benefit payments.

Pricing in the member's best interest

Superannuation funds use a number of practices to promote price stability and reduce premiums and fees paid by members. Price stabilising protect members from insurance price volatility. These price stabilisation arrangements vary in practice, all are intended to ensure that insurance risk is passed to a life insurance provider and that the benefit is passed on to the member.

Conditions which require insurers to either return payments or reduce further insurance premiums paid in certain circumstances are designed to protect the funds of members and smooth and support overall policy terms available to members in the longer term.

Price stabilisation is an appropriate commercial arrangement designed to protect the best interests of members by stabilising and reducing premiums paid by members. Those retail superannuation funds that use related party insurance providers, have little commercial incentive to reduce the premiums paid by their members.

Superannuation funds engage regularly with their insurers to ascertain the long-term level of claims experience relative to premiums charged. This enables an ongoing assessment of the sustainability of insurance arrangements. Where appropriate superannuation funds seek independent actuarial advice to assess the longer-term claims trends and the impact of fund's demographics to ascertain whether the pricing charged to members reflect the underlying longer term risks. Superannuation funds also engage with consultants to periodically reassess the appropriateness of the premiums charged via a competitive tender.

Productivity Commission Inquiry into Superannuation

The Productivity Commission is currently conducting an extensive inquiry into the Efficiency and Competitiveness of the Superannuation System. As part of the inquiry the Commission has indicated that it will review insurance arrangements within superannuation.

> *"… the Commission plans to assess whether trustees are offering the most appropriate insurance for their members, and whether the costs of insurance are minimised for the type and level of cover provided."*[12]
>
> *The Commission discusses the cost of the inevitable allocative inefficiency inherent within group insurance whilst recognising the benefits of insurance and the possible mitigating impacts of 'smart default' insurance cover which is informed by age, gender, occupation and income.*[13]
>
> *"The majority of members are defaulted into insurance on an opt-out basis. Taking the default arrangements as a given, it is relevant to assess whether the insurance products provided are meeting members' needs and being provided at least cost. A mix of quantitative and qualitative indicators will inform the assessment."*[14]
>
> *"What are the advantages and disadvantages of allocating insurance through a separate competitive process? What should be the key feature of this default insurance product?"* [15]

ISA and AIST believe it is appropriate, whether it be this inquiry, or the Productivity Commission to question the role and value of insurance within superannuation. We believe that all superannuation trustees have an obligation to continually assess if the funds they operate are offering insurance products that meet member's needs, taking into account the nature of membership, at an appropriate cost.

Industry focus on improving member offerings

Getting the default settings right

Most fund members do not dial up or down the default insurance allocated to them, [16]and few opt out of insurance altogether. it is therefore important that superannuation funds set their default levels of insurance at an appropriate level. Not-for-profit funds do so by considering their member demographic. The industry and occupational base flowing from the default fund allocation process assists in the identification of member need as does the employer and employee representation on the trustee boards.

The current default superannuation arrangements also act to protect members who have just commenced employment as it ensures that until the first employer contribution is received for a member, they and their families are adequately covered by automatic default arrangements. In the absence of such default insurance arrangements there exists the possibility that members would have gaps in cover with the consequent risk of benefits not being provided until the first SG contribution is received by a chosen fund. The existence of default fund arrangements therefore work to complement and minimise the risks for members in these circumstances.

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[12] Page 8 Productivity Commission Draft Report How to Assess Superannuation Competitiveness and Efficiency - September 2016

[13] ibid pages 69-70

[14] ibid page 107, also see substantive discussion between pages 144-151

[15] Page 11 Productivity Commission issues paper September 2016

[16] Limited antidotal evidence indicates that there can be a significant variance in incidences of members altering default insurance levels depending on occupational coverage and age

Remove conflicts of interest

Not-for-profit funds recognise the importance of maintaining a strong and transparent relationship with insurers and reinsurers to increase capacity, reduce concentration risk, improve transparency and maintain competitive tension. However, this relationship is at arm's length.

In October 2014 ASIC's review of the life insurance industry[17] found that there were systemic issues within the industry that effectively resulted in market failure. ASIC's review found that 37 per cent of insurance advice was inappropriate and an incredible 96 per cent of the inappropriate advice was given by advisers remunerated by insurers' commissions. The ASIC review further found that where an adviser is paid an upfront commission, it has a statistically significant bearing on the likelihood of that adviser giving advice that does not comply with the law.

In March 2015, the Trowbridge Report, commissioned by the Association of Financial Advisers and the Financial Services Council made a number of recommendations for change, including the reduction or restriction of certain commission payments.

The industry working together

Australia's superannuation bodies comprising the Association of Superannuation Funds of Australia (ASFA), the Australian Institute of Superannuation Trustees (AIST), the Financial Services Council (FSC), the Industry Funds Forum (IFF) and Industry Super Australia (ISA) recognise that the provision of group insurance within superannuation has significant benefits to individuals and society. It is also recognised that all stakeholders have a responsibility to ensure there is continuous improvement to ensure members' interests are protected and insurance continues to offer value for money. Attachment 1 details a joint statement of intent by the collective representatives of industry stakeholders, including superannuation funds and insurers.

The same stakeholders have, in association with insurers and consumer representatives established a Superannuation Industry Working Group. Considerable resources will be allocated to the Working Group to assess and address issues relating to insurance within superannuation to ensure settings are, where required, improved to the benefit of fund members. Attachment 2 details a joint media release on 2 November 2016 outlining the group's establishment and aims.

The industry is working towards the establishment of a code of practice and conduct. It is the preference of ISA and AIST that this code will include enforceable consumer protections and will be approved by ASIC.

[17] ASIC Report 413 Review of retail life insurance advice

Suggestions for regulatory change

Life Insurance remuneration

ISA and AIST believe that all forms of commissions for the sale of life insurance products should be banned. The clear evidence is that commissions in the industry have distorted the market. ISA and AIST recognise that the Government has introduced the Corporations Amendment (Life Insurance Remuneration Arrangements) Bill 2016, however the provisions of the Bill, which is soon to be reintroduced into Parliament, do not adequately address the systemic conflicts in the industry. The Bill's limited interference with the commission model of remuneration, clawbacks and grandfathering restricted its impact. ISA and AIST support the banning of commissions in the life insurance industry.

Disclosure requirements

Until such time as commissions associated with the provision of life insurance are banned, conflicts will continue. The government should require advisers to make a clear and prominent disclosure statement regarding any commission payments in Statements of Advice and fee disclosure statements. At this point in time there is no requirement for commissions paid by insurers to be disclosed. There is a clear need for Financial Disclosure Statements to prominently and clearly disclose to consumers the level of commission paid and the likely impact on the consumer of the commission payment.

ASIC

ISA and AIST welcome ASIC's ongoing interest in the insurance industry. The two industry bodies are involved in industry initiatives to further improve insurance offerings to superannuation fund members. A core component of this initiative is to develop a code of conduct/practice which is capable of being approved by ASIC under RG 183.

We are of the view that the government should introduce further disclosure requirements and ASIC should publish regulatory guidance on those requirements to maximise consumer engagement and understanding.

ASIC should publish guidance on analysis advisers are required to undertake when recommending that a client use Superannuation Guarantee contributions to fund the purchase of insurance.

Attachment 1:

GROUP INSURANCE STATEMENT OF INTENT

Australia's superannuation bodies comprising the Association of Superannuation Funds of Australia (ASFA), the Australian Institute of Superannuation Trustees (AIST), the Financial Services Council (FSC), the Industry Funds Forum (IFF) and Industry Super Australia (ISA) share a common belief in the following principles underlying group insurance in superannuation:

1. Group insurance in superannuation has been a successful policy for Australia which has resulted in better risk protection for Australians from all walks of life.

2. It provides a safety net to millions of Australians who would have otherwise not chosen or been unable to take out life and disability insurance individually.

3. Automatic default cover in superannuation, provided to members on an opt-out basis, has helped combat the problem of underinsurance in Australia.

4. Superannuation trustees and group insurers must work together in order to achieve the most sustainable benefits for members.

5. The following initiatives have been undertaken over the past 18 months as part of the industry's commitment to sustainable, high quality group insurance cover:

    - FSC's Life Insurance Code of Practice, to be released on 11 October, which places binding obligations on life insurers
    - ASFA's Protocols for superannuation TPD Claims
    - IFF's group risk insurance management framework, which addresses issues such as automatic acceptance levels, TPD definitions, fee arrangements for lawyers and data
    - The IFF-led Insurance Data Standards working group
    - AIST Insurance Community of Interest initiative to consolidate benefit design, practice, system and data issues
    - FSC/AIST/IFF/ISA jointly-developed guidance note: *Best Practice for Group Insurance Data Collection*

6. Group insurance in superannuation is fundamentally the right policy setting for millions of Australians but it can be improved. We intend to build on these current initiatives to consolidate our efforts in future iterations of industry policy development.

Attachment 2:

JOINT MEDIA RELEASE: INSURANCE IN SUPERANNUATION WORKING GROUP

Wednesday 02 November

Australia's superannuation industry bodies, the Australian Institute of Superannuation Trustees (AIST), the Association of Superannuation Funds of Australia (ASFA), the Financial Services Council (FSC), the Industry Funds Forum (IFF) and Industry Super Australia (ISA) have established the Insurance in Superannuation Industry Working Group.

The group will contain representatives from funds, insurers, consumer groups and industry bodies, who will develop leadership on insurance and a Code of Practice/Conduct for life insurance in superannuation.

The group will develop new standards for trustees and insurers that will set the benchmark for industry practice into the future. The standards will set out how the industry will operate to deliver valuable insurance that meets the needs of individuals and the community.

It is intended for the Code of Practice/Conduct to be binding, enforceable and contain mechanisms for independent administration and monitoring to enhance consumer protections. The intention is to finalise the Code before the end of 2017. However improvements to industry practice will be progressively delivered throughout 2017.

The Industry Working Group will build on the Group Insurance Statement of Intent released on 7 October, outcomes from a roundtable of key stakeholders held in Canberra on 10 October and the Life Insurance Code of Practice released on 11 October.