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Member

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Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
PO Box 6100
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Dear Secretary

OPTIONS FOR GREATER INVOLVEMENT BY PRIVATE SECTOR LIFE INSURERS IN WORKER REHABILITATION

The Australian Prudential Regulation Authority (APRA) welcomes the opportunity to provide its views to the Parliamentary Joint Committee on Corporations and Financial Services on Options for greater involvement by private sector life insurers in worker rehabilitation.

APRA's mandate is to undertake prudential supervision of regulated institutions, which includes life insurers and private health insurers (PHIs). In undertaking this mandate, APRA is required to balance the objectives of financial safety and efficiency, competition, contestability and competitive neutrality, and, in balancing these objectives, to promote financial system stability in Australia.[1]

APRA notes the submission of the Financial Services Council (FSC) to the Parliamentary Joint Committee on Corporations and Financial Services (Life Insurance Industry) dated 12 November 2017 regarding regulatory constraints on life insurers to provide early intervention to support consumers. APRA acknowledges the FSC's comments that some "current legislative arrangements prevent life insurers from offering targeted rehabilitation benefits in certain circumstances". APRA agrees that provisions including (but not limited to), for example, section 234 of the *Life Insurance Act 1995*, section 126 of the *Health Insurance Act 1973*, section 10 of the *Private Health Insurance (Prudential Supervision) Act 2015*, section 121-1 of the *Private Health Insurance Act 2007* and regulation 4.07D of the *Superannuation Industry (Supervision) Regulations 1994*, operate together to prevent the life insurance industry from providing benefits to policyholder claimants for rehabilitation expenses in some circumstances.

The impact of these legislative restrictions on the ability of life insurers to provide early rehabilitation benefits and medical expenses for policyholders - particularly as they relate to

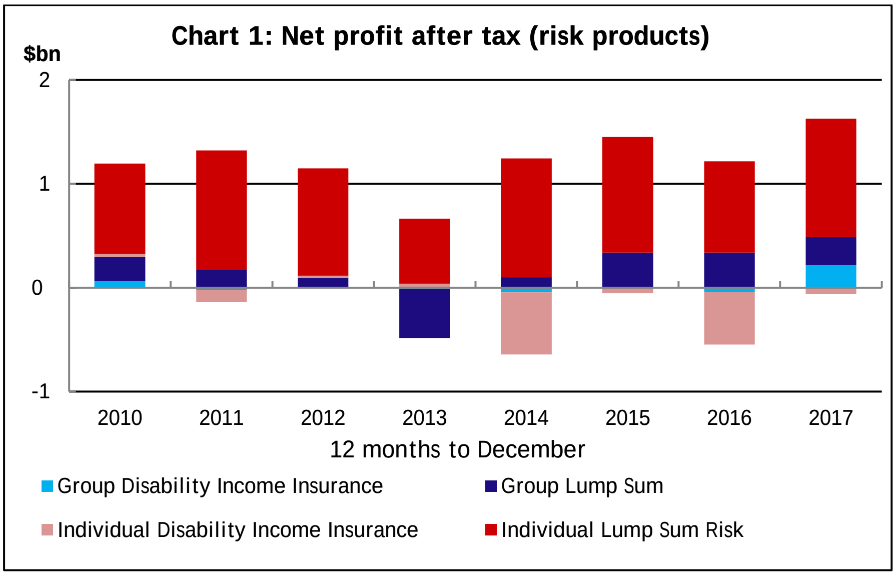
[1] Refer to section 8(2) of *the Australian Prudential Regulation Authority Act 1998*.

the interaction between life insurance business, private health insurance business and the health system generally – is an issue raised with APRA from time to time. It has become more prominent as life insurers have become increasingly interested in rehabilitation over recent years, with many insurers now investing in in-house rehabilitation resources.

APRA does not collect data on this issue and is therefore unable to provide an analysis of how wide-ranging this issue is or assess its impact upon policyholders. However, APRA is aware of anecdotal evidence suggesting the current regulatory settings may have unintended consequences that are detrimental to policyholders in certain situations. There is growing evidence that early intervention should in principle be expected to improve outcomes for policyholders, as the likelihood of a person returning to work declines significantly the longer their absence from work, while their medical expenses increase.[2]

The setting of the legislative requirements relating to interaction between life insurance business, private health insurance business and the health system generally is a matter of government policy. If however the government was of a mind to amend the current framework, APRA is of the view that, subject to careful design (see below), it would be unlikely to have adverse impacts from a prudential perspective. Conversely, it may have the potential to improve the sustainability of the life insurance industry over time by supporting the ability of insurers to assist claimants in returning to work.

While life insurers have been profitable between 2009 and 2016, this has been primarily driven by Individual Life Lump Sum business,[3] masking low returns and material losses experienced by individual disability income insurance (DII) and group lump sum business lines. While recent increases in premium rates for group lump sum insurance to more sustainable levels has assisted in its return to profitability, substantial losses in individual DII have continued (refer to Chart 1).



[2] For example, refer to the references in the Financial Services Council submission of 12 November 2017 to the Parliamentary Joint Committee on Corporations and Financial Services (Life Insurance Industry).

[3] Individual Life Lump Sum business includes Death Cover, Trauma, and Total and Permanent Disability (TPD) insurance.

Sustained losses for the life insurance industry in specific business lines is of concern to APRA, and the sustainability of the industry remains an issue that APRA continues to address. While much of APRA's focus has been on the sustainability of group insurance and the potential impact on insured benefits offered to superannuation fund members, clearly the significant deterioration in the profitability of DII is problematic over the longer-term.

There is no single cause of these losses in individual DII, but key drivers include:

- unsustainable pricing;
- weaknesses in benefit design;
- claims management – inadequate resourcing and skills;
- overly complex terms and conditions on current and legacy DII policies;
- competitive pressures; and
- lack of access to data and analytics, including up-to-date broad industry experience studies.

APRA will continue to address these issues and in particular for individual DII, the focus will be on improving the sustainability challenges with current pricing structures and benefit design.

Encouraging life insurers to continue to develop their ability to provide early and targeted rehabilitation and medical benefits to improve return to work rates for DII policyholders is one element that could be of assistance in achieving this outcome. Life insurers could be supported in this regard through appropriately designed legislative changes to remove some of the impediments above. According to a recent study conducted by Swiss Re, for every $1 spent on rehabilitation services, life insurers saved on average $25 in claim reserves.[4] This in turn should assist in keeping premiums affordable for consumers.

The interaction between the relevant pieces of legislation that impact this issue are however complex. If the government was to consider changes to the legislative framework administered by various agencies, APRA believes care would need to be taken to ensure that there were no unintended consequences and that the desired policy outcomes continued to be met across the life insurance, private health insurance and the health system more generally.

APRA would also suggest that if consideration were to be given to allowing life insurers to increase their involvement in worker rehabilitation, any changes should ensure consumers are not disadvantaged and that any potential conflicts of interest, particular for life insurers, are addressed.

Finally, APRA would note that the current framework can also cause issues for PHIs, who may be restricted from covering certain treatment options for policyholders that may be more suitable. This can not only produce poorer outcomes for policyholders, but may flow into more

[4] Swiss Re, Rehabilitation Watch 2016, Australia, p.24.

costly claims for PHIs and ultimately higher premiums. According to Private Healthcare Australia, affordability is the key concern of policyholders.[5]

I look forward to following the progress of the inquiry and considering its recommendations. If you have comments on the contents of this letter or wish to seek further information, please do not hesitate to contact me or Mr Peter Kohlhagen, Senior Manager, Policy Development, on or

Yours sincerely

Geoff Summerhayes

[5] Private Healthcare Australia, submission to the Senate Community Affairs References Committee inquiry into the value and affordability of private health insurance and out-of pocket medical costs, July 2017.