

# AIA Australia response to Questions on Notice

## ‘Protecting Your Super’ Package



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| Rice Warner says the likely impact on premiums for the rest of the pool is 5-10%. KPMG, in 2017 research which we understand was commissioned by ISA suggested 7-10%, and recent KPMG analysis now suggests 26% (this despite CBUS, the super fund for hazardous works who will                                                                                                                                   |           |

presumably see the greatest impact on premiums for the rest of the pool, estimating a change of 20-30%). Which percentage do you think is most realistic and why? Can you confirm whether you are a client of RiceWarner, KPMG or both?

**Question 11.....14**

Do you offer IP policies to age 60? If so, what is the premise of such policies, given IP is for temporary incapacity, rather than permanent incapacity?

**Question 12.....15**

What percentage of the affected cohorts receive a claim pay out of any kind within the first two years of employment?

**Question 13.....16**

In light of the sweeping/reuniting provisions in the Bill (in other words, assuming that after 13 months low balance multiple account holders will no longer exist), what is your best estimate of the likely time it will take (from approx. the 13 – 14 month mark) for both a low and average income earner to reach \$6k in their single remaining active account?

# Executive Summary

Thank you for inviting AIA Australia to respond to Questions on Notice from the Senate Estimates Legislation Committee.

As an introduction to the questions posed, AIA Australia offers the following observations.

## Cross-subsidies

Group life insurance is a collective humanitarian group response to risk, a response that all Australians benefit from in terms of pooling of risk and economies of scale. The current system works by distributing risk across the pool of members, it effectively forms a 'community rating' within the fund allowing for lower premiums, little underwriting (if any) and broad coverage. The auto-enrolment also allows for lower cost administration. It provides a robust payoff at the wider societal level via cross-subsidisation of risk across large groups of individuals in their individual group schemes.

However, we agree that there is no place for inappropriate levels of cross-subsidy where young members are subsidising costs of older members. The data contained in these responses shows that cross-subsidies continue to exist across different age bands.

To minimise inappropriate cross-subsidies, many trustees are already tailoring their benefit design by age so that the proportion of premiums collected for each age band is close or equal to the proportion of claims paid for that cohort. For some funds, who had higher levels of cross-subsidisation, this process is being undertaken over time in order to minimise the risk of premium shock to the rest of the pool.

We agree that more needs to be done to minimise these types of inappropriate cross-subsidies, however, we do not believe that transitioning to an opt-in model for select cohorts is the correct policy response. Many funds have already successfully transitioned to benefit designs tailored by age that ensure the proportion of premiums collected for each age band is close or equal to the proportion of claims paid for that cohort. Policy targeted at achieving this outcome across the entire system without moving to an opt-in model for select cohorts would promote fairness, protect balances and not leave people exposed the risks of being without essential financial protection.

## Unique demographics of each superannuation fund

The demographics of each fund are very different, their members have different risks and varying needs. For these reasons, a standardised, externally-imposed and inflexible approach to insurance cover – such as mandating an opt-in structure for specific cohorts – is sub-optimal in the superannuation context.

Trustees are best placed to select the appropriate benefit design for their member cohort. Trustees are becoming increasingly sophisticated in their use of member data to tailor cover for segments of their cohorts based on factors such as age.

This process should continue to evolve, potentially supplemented by design principles or premium/cover caps. Alternately, the legislation could allow for trustees to provide cover on an opt-out basis for affected cohorts on an exception basis, where approved by the relevant regulator. This could help ensure that those who are particularly exposed to risk retain cover on an opt-out basis.

## Transition timing

Irrespective of the form of the final legislation, additional time needs to be given to superannuation trustees and insurers to implement the proposed changes.

The July 2019 timeframe was described by APRA as 'very challenging and realistically unachievable'.

Re-pricing policies has long lead-times. It will not be possible for insurers to review and re-price all of their group insurance arrangements in this timeframe. In some cases, there may be an inability to complete this contractually, until the expiry of current premium rate guarantees, as such a scenario as proposed by the Budget announcements would never have been contemplated in previous agreements. This could result in some insurers experiencing losses with respect to particular plans, raising sustainability concerns.

Premium increases may be relied upon to mitigate uncertainty arising from the significant changes to the risk pool. Additional time would allow trustees and insurers to find solutions that may minimise upward pressure on premiums, and also run extensive actuarial analysis to inform stable and sustainable premiums and produce better outcomes for members.

Additional time is also recommended to allow funds to undertake significant communications activities to drive member engagement and meet appropriate disclosure obligations. The current timetables pose significant hurdles for trustees and insurers that will lead to administration issues, errors and member detriment, which likely would manifest itself in increased disputes and potentially litigation.

*Unless otherwise specified, the data contained in these responses has been calculated with reference to the 12 month period between 1 July 2017 and 30 June 2018. Where there is reference to a five year period, this is for the period 1 July 2013 to 30 June 2018.*

## Question 1

Please provide your claims ratio (the percentage of premiums collected that are returned to the particular cohort in paid out claims) for the following cohorts:

- a) Under 25s;
- b) Under \$6,000 but active;
- c) Under \$6,000 and inactive; and
- d) Over \$6,000 and inactive for at least 13 months.

AIA Australia currently protects approximately 3.25 million group insurance members through superannuation. Of these members, we have approximately 700,000 members (10-15% inactive) under 25 and 675,000 members (30-35% inactive) who are 25 and over but have balances that are less than \$6,000. AIA Australia does not have data on account balances for all funds, we have applied an assumption based on the available experience.

[REDACTED]

[REDACTED]

The data shows that there is a level of cross-subsidisation across age cohorts. However, the level of cross-subsidisation will vary from fund to fund. [REDACTED]

[REDACTED]

[REDACTED]

The majority of funds are in the process of transitioning towards this type of structure that minimises cross-subsidisation across age groups. For many, particularly those who previously had higher levels of cross-subsidisation, this has been done over a gradual period to reduce potential premium shock for the rest of the pool. This demonstrates that with the right benefit design, cross-subsidisation across age cohorts can be minimised, while still ensuring members have essential financial protection. We recognise that there is work to be done as part of this journey, but we do not believe that an opt-in model for specific cohorts is the correct policy response.

## Question 2

Please confirm the number, amount (\$) and percentage of death and TPD claims (when compared to all death and TPD claims paid for the same cohort) paid to under 25s and to over 25s, but with low balance accounts, in hazardous occupations, in circumstances where the injury was sustained at work (not driving on the way to work) as a result of the type of work?

AIA Australia does not have data on account balances for all funds, we have applied an assumption based on the experience that we have available. AIA Australia is not able to determine in the time frame available which claims are sustained at work as a result of the type of work. We have adopted the assumption that 'accidents' are work related injuries, excluding accidents related to hanging/strangulation, motor vehicle accidents, and drug/alcohol toxicity.

Based on the demographics of the superannuation funds that AIA insures, we believe that we would have a relatively low proportion of members who work in hazardous occupations.

### Death Claims - hazardous occupations, in circumstances where the injury was sustained at work as a result of the type of work

| Cohort                                               | Number of claims paid |         | \$ amount of claims |         | Percentage of all death claims for that cohort |         |
|------------------------------------------------------|-----------------------|---------|---------------------|---------|------------------------------------------------|---------|
|                                                      | 12 months             | 5 years | 12 months           | 5 years | 12 months                                      | 5 years |
| Under 25                                             | 11                    | 48      | 1.4m                | 5.5m    | 7%                                             | 6%      |
| 25 or over with an account balance less than \$6,000 | 62                    | 252     | 12.8m               | 44.5m   | 11%                                            | 9%      |

### TPD Claims - hazardous occupations, in circumstances where the injury was sustained at work as a result of the type of work

| Cohort                                               | Number of claims paid |         | \$ amount of claims |         | Percentage of all TPD claims for that cohort |         |
|------------------------------------------------------|-----------------------|---------|---------------------|---------|----------------------------------------------|---------|
|                                                      | 12 months             | 5 years | 12 months           | 5 years | 12 months                                    | 5 years |
| Under 25                                             | 2                     | 11      | 0.3m                | 1.6m    | 5%                                           | 6%      |
| 25 or over with an account balance less than \$6,000 | 58*                   | 445^    | 6.7m                | 46.3m   | 15%                                          | 15%     |

\* Further 33 claims under assessment.

^ Further 48 claims under assessment.

### Question 3

Please confirm the number, amount (\$) and percentage of IP and TPD claims (when compared to all IP and TPD claims paid for the same cohort) paid to under 25s and to over 25s, but with low balance accounts, for both hazardous occupation work injuries and mental health claims across all industries?

#### IP Claims – hazardous occupation work injuries

| Cohort                                               | Number of claims paid |         | \$ amount of claims* |         | Percentage of all IP claims for that cohort |         |
|------------------------------------------------------|-----------------------|---------|----------------------|---------|---------------------------------------------|---------|
|                                                      | 12 months             | 5 years | 12 months            | 5 years | 12 months                                   | 5 years |
| Under 25                                             | 9                     | 51      | 0.1m                 | 0.6m    | 6%                                          | 6%      |
| 25 or over with an account balance less than \$6,000 | 101                   | 605     | 1.7m                 | 18.2m   | 11%                                         | 11%     |

\* Excludes open claims reserves (ongoing claim payments for continuing IP Claims).

#### IP Claims – mental health claims across all industries

| Cohort                                               | Number of claims paid |         | \$ amount of claims* |         | Percentage of all IP claims for that cohort |         |
|------------------------------------------------------|-----------------------|---------|----------------------|---------|---------------------------------------------|---------|
|                                                      | 12 months             | 5 years | 12 months            | 5 years | 12 months                                   | 5 years |
| Under 25                                             | 22^                   | 88~     | 0.3m                 | 1.8m    | 22%                                         | 19%     |
| 25 or over with an account balance less than \$6,000 | 122                   | 685     | 3.2m                 | 32.2m   | 20%                                         | 20%     |

\* Excludes open claims reserves (ongoing claim payments for continuing IP Claims).

^ Further 12 claims under assessment.

~ Further 12 claims under assessment.

#### TPD Claims – hazardous occupation work injuries

| Cohort                                               | Number of claims paid |         | \$ amount of claims |         | Percentage of all TPD claims for that cohort |         |
|------------------------------------------------------|-----------------------|---------|---------------------|---------|----------------------------------------------|---------|
|                                                      | 12 months             | 5 years | 12 months           | 5 years | 12 months                                    | 5 years |
| Under 25                                             | 2                     | 11      | 0.3m                | 1.6m    | 5%                                           | 6%      |
| 25 or over with an account balance less than \$6,000 | 58*                   | 445^    | 6.7m                | 46.3m   | 15%                                          | 15%     |

\* Further 33 claims under assessment.

^ Further 48 claims under assessment.

#### TPD Claims – mental illness claims across all industries

| Cohort                                               | Number of claims paid |         | \$ amount of claims |         | Percentage of all TPD claims for that cohort |         |
|------------------------------------------------------|-----------------------|---------|---------------------|---------|----------------------------------------------|---------|
|                                                      | 12 months             | 5 years | 12 months           | 5 years | 12 months                                    | 5 years |
| Under 25                                             | 4*                    | 38^     | 0.5m                | 4.9m    | 9%                                           | 20%     |
| 25 or over with an account balance less than \$6,000 | 69                    | 478     | 8.2m                | 62m     | 19%                                          | 19%     |

\* Further 12 claims under assessment.

^ Further 18 claims under assessment.

## Question 4

What is the average TPD claim pay out for under 25s and under 6k cohorts?

The below table shows the average TPD claim pay-out for under 25s and for members with a balance below \$6,000.

Coverage levels are indicative of superannuation trustees seeking to strike the right balance between protecting member balances from inappropriate erosion, and providing protection against the risk of a working life cut short.

Insurance in superannuation is generally considered a minimum level of default cover that meets basic needs (a safety-net). Superannuation trustees and the group insurer will encourage individuals to consider their specific insurance needs, and whether they need to consider opting in to additional voluntary cover that would meet their specific needs. This model helps to strike the correct balance between insurance cover and retirement savings, and over/under insurance.

This is consistent with their obligations under section 52(7) of the *Superannuation Industry (Supervision) Act 1993* (Cth).

Superannuation Prudential Standard 250 requires trustees to have an Insurance Management Framework detailing their insurance strategy, as well as how they have considered each of the factors outlined in 52(7).

|                                                    | Over the last 12 months | Over the last 5 years |
|----------------------------------------------------|-------------------------|-----------------------|
| Average TPD claim pay-out for under 25s            | \$150,000               | \$130,000             |
| Average TPD claim pay-out for under \$6,000 cohort | \$140,000               | \$142,000             |

Coverage levels are generally tailored for age, with a lower level of cover at younger ages, increasing steadily and then decreasing as the member may have other savings and assets to protect them should injury or illness prevent them from working. [REDACTED]

Shifts in cover level and propensity to claim are reflected in premiums, which also vary based on age, as reflected in [REDACTED]

When we conducted the AIA Life Today Study (2016), we found that in relation to default coverage provided in superannuation, for the respondents:

- 55% wanted to keep their cover at the same level;
- 22% wanted to increase their cover;
- 14% didn't know;
- 4% wanted to reduce their cover; and
- 4% wanted to remove cover altogether.

These results show that the majority of respondents were satisfied with the level of cover provided to them on a default basis.

## Question 5

What percentage of death and TPD claims are paid to under 25s?

The below table shows the percentage of death and TPD claims paid to under 25s as a percentage of all death and TPD claims paid.

The data reflects that younger members do make claims, and that the sum insured for death and TPD cover is generally lower than for other age cohorts. This is reflected in the premiums charged – generally less than the price of a cup of coffee each week for members under 25.

At an industry level, RiceWarner (Underinsurance in Australia 2017) estimates that:

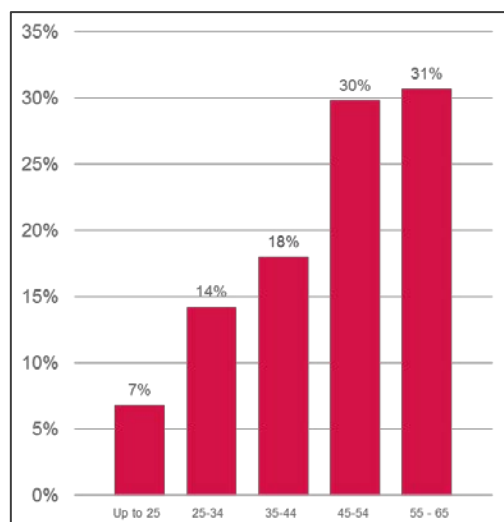
- For people aged 20 the age dependent TPD rate is 0.0541%, while for people aged 30 it is 0.0471%;
- For people aged 20 the age dependent IP rate is 0.2951%, while for people aged 30 it is 0.3291%;
- For males aged 20 the age dependent death rate is 0.0488%, while for males aged 30 it is 0.0769%; and
- For females aged 20 the age dependent death rate is 0.0224%, while for males aged 30 it is 0.0357%.

Propensity to claim, as well as other factors including insurance needs, are taken into account in pricing and benefit design.

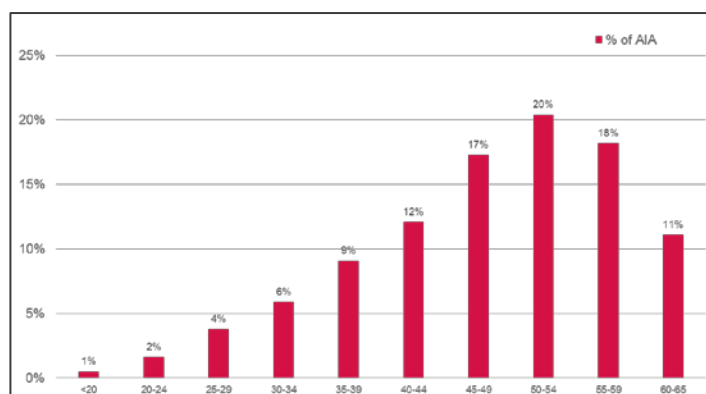
**Percentage of death and TPD claims that are paid to under 25s (as a percentage of all death claims paid) over 5 year period**

|                                     | By \$ | By count |
|-------------------------------------|-------|----------|
| % of death claims paid to under 25s | 4%    | 6%       |
| % of TPD claims paid to under 25s   | 2%    | 2%       |

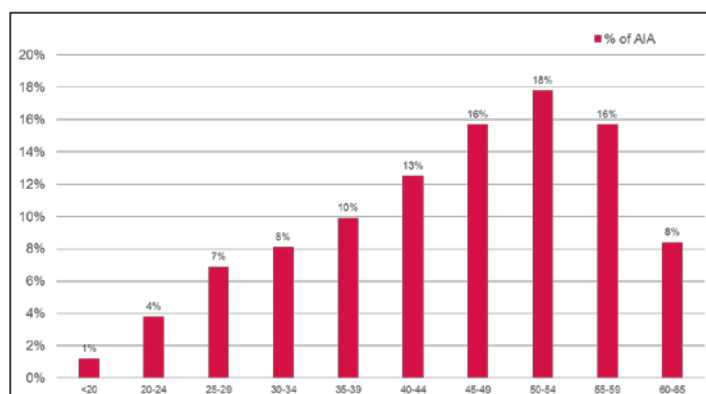
**Death Claims by Age Band:  
Calendar years 2015 - 2017**



**TPD Claims by Age Band: Calendar years 2015 - 2017**



**IP Claims by Age Band: Calendar years 2015 - 2017**



## Question 6

What percentage of claims paid to under 25s are paid to a dependant spouse or spouse and children, and not to an estate?

Life insurers generally do not collect this data. Life insurers make claim payments to the superannuation trustee, and the trustee will release the funds to the individual member, or in the case of death insurance to their dependents, or estate. Trustees may be better placed to provide data in response to this question.

We note that the CBUS submission to the Senate has indicated that 60% of death benefits for those aged 21 – 25 are paid to a dependant and/or spouse.

We expect that this experience would differ based on the unique demographics of each fund. This is one reason why some stakeholders have supported a 'by exception' rule which would allow trustees to offer cover on an opt-out basis where approved by the relevant regulator.

It should be noted that all disability insurance claims (TPD and IP) are paid to the claimant member. This is an important distinction on the differing purposes of death cover as opposed to disability cover.

- Death cover assists families adjust to having one less income stream and helps to provide for the dependants of the deceased, it may also cover outstanding debts and funeral costs.
- Disability cover helps to replace income if individuals cannot work due to sickness or injury. This can take the form of a regular payment (IP) or a lump sum style payment (TPD).

The argument advanced by the Government and the Productivity Commission is that young people do not need life insurance because they do not have any dependents. While this argument may be true for the majority of people under 25, it is only relevant with respect to death cover. The *Superannuation Guarantee (Administration) Regulations 1993* (Cth) currently mandate a minimum level of death cover for members aged 20 to 34 of \$50,000 (subject to reasonable conditions as the trustees of the fund determine, or if the member elects to opt-out).

For young people disability cover is relatively more valuable, as it protects their greatest asset – their future earning potential. They are also less likely to have a high amount of savings to support them in their time of need, and less accumulated leave entitlements. Disability cover is something that all young Australians need.

## Question 7

What percentage of successful TPD claimants re-enter the workforce within 5 years?

Life insurers generally do not collect this data. For the most part, the relationship is between the superannuation trustee and the member. In many cases the trustee would not be aware if the member has returned to work or not, unless they engage specific member research or witness a resumption of employer superannuation contributions.

The experience of different funds is likely to vary significantly based on the nature of claims and demographics of the relevant fund. Funds will generally consider their unique experience in their future product design.

In 2015, Sunsuper and AIA Australia conducted a research looking at the experience of 330 TPD claimants. They found that:

- 22% had returned to work (19% fulltime, 3% part-time);
- 82% of those who had returned, returned within 2-3 years of their claim;
- an additional 14% were actively seeking employment at the time;
- of all claimants, 66% indicated that they wanted assistance in finding a job;
- 69% wanted assistance in retraining/up-skilling; and,
- in terms of spending the claim benefits received:
  - o 59% was spent on everyday living;
  - o 31% on medical treatment;
  - o 9% on cars and holiday; and
  - o 2% invested the money.

MTAA conducted research in 2016 looking at the experience of 223 TPD claimants. They found that:

- 7% had returned to work within 1 – 5 years of being paid;
- an additional 25% were actively looking for work;
- in terms of spending the claim benefits received:
  - o 59% on living expenses and debt reduction;
  - o 20% on medical or rehabilitation costs;
  - o 20% on legal costs; and
  - o 1% on assistance in returning to work.

This may indicate that the benefit provided gave the member the time and resources to recover, reskill, undertake medical treatment and subsequently re-enter the workforce. As default insurance provides a safety-net style benefit, once this is exhausted individuals may need to return to work due to their financial situation. Without default insurance, individuals would not have the support necessary during this transition period, noting that insurers also provide a range of additional support services such as occupational rehabilitation to assist members in returning to work.

## Question 8

Is it legally possible, where an insurance contract already covers an individual in one of the affected cohorts, and that individual opts-in to retain that existing policy, that the insurer can then choose to underwrite the individual's cover?

Given the magnitude of these proposed changes, AIA Australia and superannuation funds are still assessing any potential impacts on how group insurance through superannuation will be offered after 1 July 2019. AIA Australia's initial views are that if the current Treasury Laws Amendment (Protecting Your Superannuation Package) Bill 2018 is enacted into law in its current form the following principles will likely apply:

1. Where a member is already covered under a group insurance policy and that member falls within one of the affected cohorts the individual's insurance cover will cease, unless they have previously made an election to maintain cover. The Bill requires that:
  - a. where a member makes an election to maintain their cover before they fall within the relevant affected cohorts (i.e. before their account balance falls below \$6,000 or becomes inactive) their cover will continue unaffected; and
  - b. where a member fails to make an election to maintain their cover before they fall within the relevant affected cohorts their cover will cease.
2. Where a member's cover has ceased, in order to reobtain cover the member would need to reapply as if they never had cover which would involve being re-underwritten in accordance with the terms of the policy (e.g. similar to current arrangements where the member would like to increase their cover beyond automatic acceptance limits, or where they have previously opted-out and are now opting back in).

Based on the above our view is that the new laws would not prohibit insurers from requiring a member to reapply or be re-underwritten for cover in order to reobtain cover that had ceased. However, if a member makes an election (opts-in) to retain their existing policy in accordance with the legislation and as a result their cover does not cease at any point, it is not legally possible to then re-underwrite the member for the existing insurance cover they have elected to retain.

AIA Australia recognises that the circumstances created by these reforms could result in some members being negatively impacted and AIA Australia is considering potential solutions to help mitigate these impacts. For example, one possible solution could be to include reinstatement rules in the policy which allow automatic reinstatement of cover where a member within the relevant affected cohorts reapplies for cover or receives a contribution within a particular timeframe. The reinstatement rules could also provide that in these circumstances a member's cover would be treated as if it had never ceased to avoid members being left without cover during the period after their cover ceased and before they reapplied.

However, the inclusion of such rules is not guaranteed as they are likely to create selection risk that will ultimately make cover more expensive, and this would be a factor fund trustees consider when determining the most appropriate insurance design for fund members. Increased cost flowing from these types of reinstatement rules could be avoided by continuing to offer cover on an opt-out basis to under 25s and members with low but active balances.

It is more likely that funds and insurers will include tougher underwriting requirements where the timing of cover commencing is not linked to a defined event. Where members are free to opt-in to cover at any time, e.g. due to a health scare, this increases the likelihood of the claims paid by that pool exceeding those that were priced. Trustees and super funds will adopt a range of underwriting measures to mitigate that risk. This is discussed further in response to Question 9.

Further time during the implementation phase will allow trustees and group insurers to consider available options that deliver the best outcomes for members and are sustainable.

If so, what provisions in an insurance contract would allow this?

Opt-in requirements are subject to relevant reinstatement rules contained in group insurance arrangements. Group insurance policies will generally require an individual who is applying (or reapplying) for additional cover above the automatic acceptance limits in the policy to be fully underwritten (or re-underwritten). These processes are determined by the trustee as part of their overall insurance benefit design, considering the potential impacts on pricing.

Is this position likely to change when insurance contracts are brought within the Unfair Contracts Terms legislation?

The Unfair Contract Terms (UCT) regime for life insurance has not yet been finalised. The insurance UCT regime may contain a broad "main subject matter" carve-out clarifying that terms relating to the scope of insurance cover, its price or underwriting are not caught by the regime in line with the similar insurance UCT regimes that operate in New Zealand and the European Union. A broader definition of 'the main subject matter' is preferred as a narrower definition has the potential to limit choice for consumers and to make cover more expensive. This could potentially contribute to further underinsurance in the community.

## Question 9

What will be the likely reason why funds' would require their member to go through underwriting once they no longer fit within the affected cohorts? For example, we note that AustralianSuper has successfully negotiated automatic re-entry to the pool for its members once they reach 25 – will the scale and negotiating power of the fund be the a key driver in terms of whether underwriting is required?

In the group insurance context, underwriting can range from basic eligibility conditions such working in your normal duties at the time of cover commencing, through to full underwriting akin to what would be undertaken if purchasing a policy through an independent financial adviser. Trustees will need to balance entry into the risk pool, with the cost to members in that pool. Allowing cohorts of members that have a higher likelihood to claim, means more claims paid and higher costs for all members. Trustees and insurer will accept some risks and not others and tolerances will differ. This will differ depending on demographics of a particular fund.

It is likely that any member who no longer fits within the affected cohorts e.g. a member balance reaches \$6,000, will be subject to some form of underwriting. This is likely to be at the lower end of the spectrum and be similar to that which may be applied to other members who would otherwise be eligible for cover. Generally this is a requirement that someone is 'at work' – that is they are working in their usual occupation without restriction for a defined period.

While AustralianSuper have signalled their intent to offer cover for under 25's on an opt-in basis, the changes are not effective until November 2018. AustralianSuper are yet to publish the terms that will apply to members turning 25 who are not already covered so it is unclear what conditions those members would need to meet.

Rest have a similar feature in their industry fund product for younger members who have previously opted out of insurance. Cover is reinstated for members aged between 25 and 26, if they are receiving employer contributions. There is limited underwriting applied to these members – in simple terms, requiring them to be working without any restrictions caused by sickness or injury, and capable of carrying out the usual duties for at least 20 hours a week. Otherwise they are still covered for new events.

Large group insurance pools, such as AustralianSuper and Rest, can more readily spread the risk of any adverse selection by members. What is also important is the relative mix between cover granted on automatic terms, and that on an opt-in basis. Selection risk is less relevant where that cover trigger is linked to a defined event e.g. minimum age or commencing a new job, but more relevant where it is not linked to a defined event, e.g. members requesting cover because of a recent health scare.

It is more likely that funds and insurers will include tougher underwriting requirements where the timing of cover commencing is not linked to a defined event. Where members are free to opt-in to cover at any time, e.g. due to a health scare, this increases the likelihood of the claims paid by that pool exceeding those that were priced. Trustees and super funds will adopt a range of underwriting measures to mitigate that risk.

This could include requiring anyone who wants opt-in cover to be medically underwritten, akin to what someone purchasing cover through an adviser would undertake. Otherwise, it may undertake short form underwriting, which essentially asks 4 or 5 questions to ensure that the person is, and has been, in good health and is working and not restricted due to illness or injury.

Trustees and insurers may also mitigate that risk by excluding certain occupations or classes of members. For example, it may not permit those in hazardous or heavy manual occupations to opt-in unless medically underwritten or could limit the maximum amount of cover that the member can apply for – below that which other occupations may be entitled to. Trustees may also limit cover to those in casual or more transient employment. These measures would be based on historical claims experience. There are many relevant examples that we would be happy to provide if requested.

## Question 10

Rice Warner says the likely impact on premiums for the rest of the pool is 5-10%. KPMG, in 2017 research which we understand was commissioned by ISA suggested 7-10%, and recent KPMG analysis now suggests 26% (this despite CBUS, the super fund for hazardous workers who will presumably see the greatest impact on premiums for the rest of the pool, estimating a change of 20-30%). Which percentage do you think is most realistic and why? Can you confirm whether you are a client of RiceWarner, KPMG or both?

We understand that the initial KPMG modelling was an assessment of the premium impact flowing from the Insurance in Superannuation Working Group (ISWG) Code obligations, which differ significantly from the proposed budget changes.

At a high level, we expect that upward pressure on premiums could result in a premium increase for the rest of the pool of approximately 15%. The unwinding of cross-subsidies, combined with selection risk (e.g. the assumption that those who opt-in will have a higher propensity to claim), and the allocation of fixed costs across a smaller group, is likely to result in premium increases.

However, we note that this is likely to differ greatly depending on the demographics of different superannuation funds, who may be more exposed to cross-subsidies or be at greater risk of anti-selection impacts from the opt-in behaviours of the affected cohorts.

We note the Australian Government Actuary's tabled submission is predicting an increase of 7-10%. This analysis does not consider new members who will fall within the impacted cohorts, which would create further upward pressure on rates. They have also treated under 25s who opt-in as a unique pool, with an expected increase in premiums of 90%.

RiceWarner (Federal Budget Impact – Insurance) released further analysis on 31 July 2018 estimating that premium rates for opt-out members will increase by an average of 11.1%.

Selection risk exists in three ways, all of which may place upward pressure on premiums:

- Members who didn't get cover (e.g. a member aged 21) who opt-in;
- Members who have cover today, but are at risk of losing it (e.g. they are inactive for 13 months); and
- Member cohorts who were not eligible for cover, who now become eligible (e.g. their balance now exceeds \$6,000).

The results to question 1 show that inactive members do make claims. What may become difficult is where a member may have stopped work because of an illness or injury which is likely to deteriorate over time. They may not satisfy a TPD definition when they stop work as they are attempting treatment in order to return to work. Unless the member elects to retain cover, there is significant risk that the member's cover has ceased by the time they would be deemed TPD or die due to adverse progression of their illness or injury. Automatic cessation, even with numerous contact points, still creates a significant risk of cover ceasing before entitlement to claim arises. In these circumstances, members are unlikely to be engaged on considering their superannuation and insurance arrangements, instead focused on their recovery. The same observations can be made for those who may have ceased work due to a terminal illness to spend time with their family, but are unable to access benefits under terminal illness because they are not yet within the 12 or 24 month life expectancy period specified in their policy.

Insurers will need to work through these circumstances to achieve the best outcomes for members, however it is likely that these claims will be honoured on a commercial basis, creating further premium sustainability concerns.

The transition timeframe places increases the risk of upward pressure on premiums, as insurers and trustees who are navigating a series of challenges in a short period will not have the opportunity to do a considered review of processes, product design, and other terms and conditions. Premium increases may be relied upon to mitigate uncertainty arising from the significant changes to the risk pool. Additional time would allow trustees and insurers to find solutions that may minimise upward pressure on premiums, and also run extensive actuarial analysis to inform stable and sustainable premiums and produce better outcomes for members.

AIA Australia has engaged both RiceWarner and KPMG from time to time on a consultancy basis.

## Question 11

Do you offer IP policies to age 60? If so, what is the premise of such policies, given IP is for temporary incapacity, rather than permanent incapacity?

AIA Australia provides cover to a small number of superannuation fund partners where IP is offered to at least age 60.

It is important that we distinguish between the type of benefit (e.g. IP) covered and the respective condition of release (e.g. temporary incapacity).

Trustees offering IP policies to age 60 or beyond typically don't provide members with automatic TPD cover, or provide a relative low TPD sum (to assist with transition costs). These trustees have simply adjusted the way in which its members are protected against disability – whether that is temporary or permanent.

The more traditional approach is to offer a higher TPD benefit e.g. \$300,000, which is intended to provide some income support and also cover costs as the member adjusts to their new life e.g. modifications to the home. In many cases, this would be well below actual needs and any income support would be short-lived. The Sunsuper and MTAA research suggest that many who claim TPD return to work – presumably some of those doing so for financial reasons.

Some trustees have supplemented their disability cover by providing income protection for 2 years in addition to TPD. The 2 year IP benefit works in conjunction with a TPD benefit – providing income to members where there may be a chance of returning to work, with the fall back of a lump sum if totally and permanently disabled.

Trustees offering IP to age 60 or older ages, have instead determined that providing on-going income is in the best interest of their members – whether they are temporarily or permanently incapacitated. For many, their ability to earn an income is their largest asset and they have little to fall back on. IP provides support where an illness or injury may be progressing from temporary in nature to more permanent – which could take some time. In addition, some long term IP benefits provide a super contribution, continuing to grow a member's savings that can be accessed when IP benefits cease.

Further, some long term IP benefits have an option to commute to a lump sum benefit which can be accessed under permanent incapacity where the illness or injury meets the relevant condition of release.

Where cover is purchased by via a financial adviser, IP benefits are typically provided to age 65 – reflecting the underlying need for income for life. Providing long term IP in super is seeking to better align benefits with needs.

The temporary incapacity condition of release does not preclude payment of IP benefits over an extended period while the member remains off work nor if the condition becomes permanent – provided the relevant cashing restrictions are complied with. The relevant ones being payment of an income stream, providing a benefit of no more than their pre-disability income and not provided for a period exceeding the period of disablement from work.

## Question 12

What percentage of the affected cohorts receive a claim pay out of any kind within the first two years of employment?

As we do not have oversight on when a member has commenced employment, we have used the proxy of 'within two years of joining the fund', as this is an indicator that the member has commenced employment.

We recognise that the numbers for the last two cohorts are low, however we believe this reflects that it is less likely that someone would meet a 13-month inactivity test if they have been with the fund for less than two years total.

### Percentage of claims where claimant joined the fund within 2 years by cohort

|                                                  | Percentage of claims where claimant joined the Fund within 2 years |
|--------------------------------------------------|--------------------------------------------------------------------|
| Under 25s                                        | 29%                                                                |
| Under \$6,000 but active                         | 34%                                                                |
| Under \$6,000 and inactive                       | 1%                                                                 |
| Over \$6,000 and inactive for at least 13 months | 0%                                                                 |

## Question 13

In light of the sweeping/reuniting provisions in the Bill (in other words, assuming that after 13 months low balance multiple account holders will no longer exist), what is your best estimate of the likely time it will take (from approx. the 13 – 14 month mark) for both a low and average income earner to reach \$6k in their single remaining active account?

This question is better answered by superannuation trustees, and is likely to differ largely based on the demographics of specific funds.

- Based on ABS average weekly earnings in November 2017, we estimated that for an average full-time working Australian with total earnings of \$81,500, it would take 11 months to accumulate sufficient contributions in a new account to meet the \$6,000 threshold. For the average working Australian with total earnings of just under \$62,000, it would take almost 15 months to accumulate this amount.
- Previous modelling conducted by one of our trustee partners (a white collar, public sector scheme with 15% award superannuation guarantee contributions) shows that it would take approximately 6 months for a new member to accrue an account balance of \$6,000.
- Another trustee (a large industry fund) indicated that it would take 16 – 18 months on average for a new member to accrue an account balance of \$6,000.

This shows that the experience is likely to differ from fund to fund and from member to member.

Given quite a high proportion of claims lodged by members with active accounts below \$6,000 are lodged within 2 years of joining the fund (34%), this raises concerns about the lag time where new members will be exposed without adequate protection.

The measures around inactive accounts will help create a system where the majority of members will have one account, with one set of fees, and one set of insurance premiums. As noted by Mr Ian Becket (Principal Adviser on Retirement Income Policy Division at Treasury) during last Friday's hearing, in these circumstances delaying the start of insurance cover will not make a lot of difference to an individual's retirement balance, nor how long it will take them to reach an account balance of \$6,000.

RiceWarner (Economic Impact of 2018 Federal Budget Proposed Insurance Changes) calculates that at the end of a working life, the difference these changes will make to a retirement balance is negligible at 0.27% (factoring in a 15% premium increase) or 0.76% (with no changes to premiums). For Australians already over 25 there will be no benefit, only higher premiums.

For these reasons, we are concerned that measures to transition to an opt-in model for Australians aged under 25, or with balances below \$6,000 and are active, fail to strike the right balance between retirement savings and insurance cover, and over-insurance versus underinsurance. These elements will cause the bulk of the unintended consequences, including potential premium distortions.