SUPER SYSTEM REVIEW
FINAL REPORT

CHAPTER 5

Insurance in superannuation

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KEY THEMES

Issue

Insurance cover comes at the cost of foregone retirement savings and earnings. It is a trade-off that has a significant impact on the financial well-being of members. Most members do not specifically consider their insurance needs. The information trustees disclose to members about insurance is not always useful, making it difficult for members to compare insurance options and costs across funds.

Proposed solution

The Panel proposes measures, including:

- each trustee to develop an insurance management strategy specifying the types of insurance to be offered and the default minimum and permissible maximum levels of cover to be offered;
- trustees to be responsible for selecting and administering insurance cover for the benefit of members;
- death and TPD insurance to be offered on an opt-out basis in MySuper products;
- jurisdiction of the SCT to be expanded in respect of the period in which TPD claims can be brought;
- TPD definition in trust deeds to be aligned through statute to the definition in relevant insurance policy;
- commissions cannot be paid on insurance in superannuation; and
- only death, TPD and income protection insurance can be offered through superannuation funds.

Benefits for members

Members will benefit from these measures to improve insurance in superannuation as:

- trustees will be required to develop an appropriate insurance strategy for members and to be aware of all costs and features of the fund's insurance offering;
- better targeting of fund's default insurance level to the requirements of fund members; and
- members would be better able to compare insurance as more information would be available to members on the fund's website.

1 INSURANCE

Insurance cover plays a key part in the superannuation system. Superannuation funds are generally structured towards financing a period of retirement after a long engagement in the workforce. Fortunately, that is the experience of most members. However, for a significant number of members each year, total and permanent disability (**TPD**) or premature death mean that they or their dependants need to call on their superannuation savings much earlier and for a longer period than they would have expected. Insurance plays a crucial role in allowing those needs to be met. An IFSA survey of its life insurance members (covering 90 per cent of the market) found over $2.3B in claims were paid in the 2008 calendar year on nearly 35,000 policies.[1] Most Australians do not have life or TPD insurance cover outside superannuation.[2]

Table 5.1: AIST & IFF — survey of superannuation member insurance cover (June 2008)

	Death Cover	TPD Cover	Income Protection Cover
Have through super fund only	76%	59%	22%
Have other than through super fund only	1%	4%	10%
Have both	20%	8%	2%
Have neither	3%	29%	69%
Total through super fund	**96%**	**67%**	**24%**
Total elsewhere	**21%**	**12%**	**12%**

Source: IFF & AIST Member Insurance Research

The risks of death and permanent disability are not remote. In 2008, there were 12,430 deaths of married men or women of working age (20 to 64 years). This equates to more than 34 families per day losing a member and over half of these (52 per cent) involve children losing a parent. In addition, only four per cent of Australian families with dependent children have adequate levels of insurance cover according to research commissioned by IFSA in 2005.[3]

The 2008 HILDA Survey[4] found that over 235,000 working age people, living as a member of a couple with dependent children, suffered a serious injury or illness in the previous 12 months. The same survey found that over 17,000 employed people who were living as member of a couple with children had been unable to continue working due to illness, disability or injury over the previous year.[5]

Trustees have an important role in setting the insurance offerings for their members. The opportunity cost to members of premiums paid for insurance is the compounding retirement benefit they would have received had those premiums not been subtracted from their superannuation savings.

Currently, trustees must seek to strike the right balance in offering insurance to protect against the risks of being unable to contribute to an adequate standard of living and the impact of premiums paid on ultimate retirement benefits.

Life and TPD insurance are also complex products, and each fund has a different demographic of members with varying risks. Accordingly, a standard, externally-imposed approach to insurance, (such as is applied for compulsory third party motor vehicle accident insurance) would be sub-optimal in the superannuation context.

The Panel believes that trustees have, for the most part, been conscious of these considerations when setting default insurance for members. For example, some funds have adopted new approaches that provide younger members with reduced levels of cover which increases as the member progresses through life stages (gets married, buys a house, starts a family, etc) and reduces again as the member ages and the expected insurance needs decline. The Panel considers that all trustees should consider an age-based tapering policy as part of their insurance strategy.

2 UNIQUE EXPENSE

There are three important issues relating to the expenditure by trustees on insurance each of which calls on trustees to take care that they have the interests of members first and foremost in their decision-making:

- expenditure on insurance does not affect reported investment returns because it is regarded as 'below the line' expenditure;
- expenditure on insurance is tax-deductible to the fund but, unlike other expenditure, it does not detract from reported investment returns; and
- members do not always get an appropriate allocation of the tax deduction for their share of the premium paid by the fund.

3 DEFAULT LEVELS

Currently, in order to qualify as an eligible choice fund that can accept superannuation guarantee contributions, a fund must offer a minimum level of life insurance cover either at a premium of at least $0.50 per week (for a person who has not attained the age of 56 years) or that has a minimum benefit as set out in the table below.[6] These minimum levels do not take into account a member's family relationships and financial circumstances. Some trustees allow members to opt-out of default insurance cover and others do not.

Table 5.2: Minimum life insurance cover that must be offered by eligible choice fund

Age range	Level of insurance in respect of death
from 20 to 34	$50 000
from 35 to 39	$35 000
from 40 to 44	$20 000
from 45 to 49	$14 000
from 50 to 55	$7 000

These minimum levels have eroded in real terms since they were introduced in 2005. In practice, they have not acted as a proper threshold for default insurance as trustees have generally set default insurance cover levels in excess of these minimum levels, making the requirement largely redundant.

3.1 Trustees to set default levels in MySuper

While submissions generally agreed that there should be a minimum level of insurance cover within default funds, they also believed that trustees were best placed to determine this level. For example, ASFA's submission suggests that:

> *"The level of default cover should instead be determined by trustees based on adequacy levels and their knowledge of the needs of their members."*[7]

The Panel agrees with this view.

Insurance cover is taken out by a trustee through group policies that have 'automatic acceptance' provisions. This means that members are automatically eligible for the cover, assuming that they meet some basic requirements (generally to do with being at work at the relevant date). This approach provides wide cover with minimal exclusions.

The Panel considers that life and TPD insurance strongly supports the principles of the superannuation system. The Panel believes that in the MySuper sector, where members are least likely to give consideration to their insurance needs, the trustee should be required to offer life and TPD insurance on an opt-out basis.

Requiring MySuper products to offer life and TPD insurance on an opt-out basis provides a safety net to members who might otherwise not consider their insurance needs; a view supported by many submissions. This will lower the cost of insurance for most members in MySuper, because there is pooling of risk between members who face different risks and financial circumstances.

However, those MySuper members who do give consideration to their insurance situation would be able to opt-out or to purchase additional units of cover (if offered by the trustee).

Recommendation 5.1

Life insurance cover and TPD cover (where available, depending on occupational and demographic factors) must be offered on an opt-out basis in MySuper products.

The Panel believes, however, that where members decide to accept the financial risks of death or disability, perhaps because they have no dependants, or would prefer to take out insurance outside their superannuation, then this should be allowed. The retirement benefits of members should not be reduced by unwanted, but compulsory, insurance.

Recommendation 5.2

The requirement for a minimum level of life insurance that must be offered by eligible choice funds as set out in Regulation 9A and Schedule 1 to the Superannuation Guarantee (Administration) Regulations 1993 should be repealed.

3.2 Insurance strategy

The role of a trustee in selecting an insurer is analogous to the trustee's role in investing member funds. Poor management of insurance on behalf of members can substantially reduce retirement

savings. For this reason, the Panel believes that all trustees should have a new statutory duty to manage insurance and it has made this recommendation in chapter 2 (recommendation 2.1). This section fleshes out in more detail what that duty would entail.

This new duty would extend to two aspects of insurance:

(a) in the trustee's selection of an appropriate insurer and in negotiating policy terms and premium rates having regard to the financial interests of members; and

(b) in the way in which trustees will be obliged to pursue member claims with insurers when an insurer declines cover.

With respect to the second aspect, trustees would have to ensure that benefits are paid to their members in accordance with the terms and conditions of the group policy. An individual claim should be pursued by the trustee if it is reasonable to do so, having regard to the expectation of success.

Recommendation 5.3

Trustees of MySuper products, and trustees of large APRA funds that offer insurance, should have a statutory duty to manage insurance with the sole aim of benefiting members, including:

(a) selecting insurance cover with regard to the cost and value for money for members;

(b) negotiating the terms of the insurance contract, including adequacy of the level of default cover; and

(c) pursuing claims that the insurer has denied in part or in total where there is a reasonable expectation of success.

As insurance is a significant cost for members, the Panel considers that trustees should be required to devise and implement an insurance strategy, similar to the requirement for an investment strategy. This requirement should apply to all trustees of MySuper products and large APRA funds that offer insurance.

To help trustees in formulating an insurance strategy, detailed guidance should be developed by APRA.

Recommendation 5.4

The SIS Act should be amended to require trustees of MySuper products, and large APRA funds that offer insurance, to devise and implement an insurance strategy specifying the types of insurance to be offered and the default and permissible maximum levels of cover to be offered.

Recommendation 5.5

APRA should issue guidance material to trustees to help them in developing an insurance strategy.

3.3 Choice sector

In the choice sector, the Panel believes that trustees should not be required to offer any default insurance. However, if they do offer insurance, choice sector trustees must take into consideration the needs of their members in setting an insurance strategy as outlined in section 3.2. This might lead the trustee to a decision that it is not appropriate to offer insurance in relation to certain products or demographics, even though it is appropriate to offer it in relation to others.

A relevant consideration in the choice sector might be that the cost of administration of insurance (for example claims handling) may be borne across all members. Therefore, if the trustee concludes that insurance will be taken up by only a small number of members, it would be incumbent on the trustee to justify in its insurance strategy any cross-subsidisation in favour of that small number of members.

Similarly, the Panel does not believe there should be an insurance default for SMSFs; insurance in the SMSF context is discussed further in chapter 8.

Recommendation 5.6

In the choice sector, trustees should be allowed to offer life and TPD insurance on an opt-out or opt-in basis, or not at all.

4 TOTAL AND PERMANENT DISABILITY INSURANCE

TPD insurance cover is intended to provide a benefit when a person is permanently unable to work again. Usually, the policy provides a lump sum benefit to the member, but in some cases, it provides an ongoing annuity. While some funds self-insure TPD benefits, for purposes of this section, we are assuming that there is an external insurer.

In processing TPD claims, the insurer and the trustee must undertake a stringent assessment of the member's situation and condition. In certain cases, ongoing monitoring of a claimant's condition is required to ensure that they are permanently disabled. Establishing that a person satisfies the definition of total and permanent disability contained in the trust deed or insurance policy can be difficult and costly.

As the definition of TPD usually requires that the member will never be able to return to work, the member may choose to delay making a claim, to assess their condition and to determine whether there remains any possibility of returning to work. Arguably, it is in the member's and the community's interest for the period in which a member can make a TPD claim to be extended as far as practicable in order to maximise the chances of rehabilitation.

Offsets in many TPD policies reduce the benefit paid to a claimant depending on other payments that they are eligible for — such as workers' or accident compensation, sick leave or Centrelink benefits. This can result in substantial delays in benefits being paid to members and makes TPD insurance less attractive as default cover.

Also, because members might be eligible for other compensation benefits, they might not lodge a TPD claim until those other compensation benefits are exhausted. This could be a significant period of time after the member ceases work.

Trust deeds usually do not contain time limits for bringing a TPD claim, but some insurance policies do and members are not always made aware of that fact by the trustee.

However, section 14 of the Superannuation (Resolution of Complaints) Act 1993 (**Complaints Act**) does impose time limits for making a complaint to the Superannuation Complaints Tribunal (**SCT**) about a trustee decision on a TPD claim. A complaint must be made to the SCT:

- within a period of two years after the trustee makes the decision to which the complaint relates; and
- the claim must have been lodged with the trustee within two years after the person permanently ceases employment.

A member who cannot make a complaint to the SCT can challenge the decision in court. However, this often has high costs for both parties and a court is more limited in the aspects of a trustee's decision it can review. By contrast, the SCT has scope — under section 14 of the Complaints Act — to assess whether a trustee's decision is not unfair or unreasonable.[8]

The Panel recognises that a time limit helps in excluding complaints that relate to a claim that is not genuine, or where the linkage between events which led the member to cease work and the onset of total and permanent disablement can become blurred. However, the Panel believes that the current time limits for lodgement of a claim within two years of ceasing employment can unfairly exclude claimants who had reasonably delayed a claim, and therefore, recommends that it should be extended to six years.

Recommendation 5.7

The *Superannuation (Resolution of Complaints) Act 1993* should be amended to allow the SCT to consider complaints in respect of TPD claims when the claim has been lodged with the trustee within six years of the member ceasing employment and the complaint has been made to the SCT within two years of the trustee's decision.

Further, a TPD definition in a trust deed can be a barrier to successor fund transfers, as trustees are hesitant to transfer members into another fund that has insurance terms that do not match the trust deed. The Panel, therefore, considers there will be benefits for both trustees and members by deeming the definition of TPD used in a trust deed to correspond with the definition contained in any insurance contract that the trustee from time to time negotiates with an external insurer.

Recommendation 5.8

The SIS Act should be amended so that the trust deed of a large APRA fund is deemed to define total and permanent disablement in the same way as the insurance policy held by the trustee at the relevant time.

5 INCOME PROTECTION INSURANCE

Many trustees have decided to offer income protection insurance as evidence shows that most members' disability is more likely to be temporary, rather than permanent. Income protection insurance usually provides monthly benefits for up to two years or, if earlier, the date that the member recovers or becomes TPD (in which case an application for TPD is then lodged). It is particularly relevant for members who are engaged in low paid and casual employment, or who are self-employed, as these groups are unlikely to have access to paid personal sick leave.

The Panel believes that, while income protection insurance provides for current day benefits, it still supports the principles of the superannuation system. As explained in the ISN submission:

> *"Income protection provides a capacity to rehabilitate and retain members who are disabled for their own occupation with a view to returning members to the workforce that will permit them to continue fund their own retirement benefits. Furthermore, income protection can insure the member's superannuation contributions during their period of disability thereby maintain the funding the accumulation of their retirement benefits."*[9]

Trustees have increasingly turned to income protection insurance as it can help meet the immediate financial needs of members across the long period it takes to assess if the member is permanently disabled and eligible for TPD benefits.

However, the Panel acknowledges that there remain different approaches to income protection insurance. ASFA said in its submission that income protection insurance should not be required to form part of a fund's default arrangements as the cost of income protection insurance premiums (that is compared to death and TPD cover) would significantly erode members' superannuation balances, particularly smaller balances.[10]

AIST's submission noted that certain funds might have administrative difficulties in providing income protection insurance because of the need to gather, record and update salary information. There is the added complexity that employers are not currently required to pass salary information on to a super fund.[11]

The Panel notes that these administrative and cost hurdles may prevent certain funds from offering income protection insurance as a default. Therefore, trustees of either MySuper or choice funds should have the option of offering income protection insurance on an opt-out or opt-in basis, or not at all.

Recommendation 5.9

Income protection may be offered on an opt-out or opt-in basis, or not at all by trustees of MySuper or choice funds.

Other types of insurance are not structured to support the goal of superannuation to provide benefits to members in retirement, or when they are no longer able to work. Therefore, the Panel considers that it is not appropriate for them to be offered through superannuation. Trustees currently offering these other types of insurance should have a suitable transition period to phase-out existing policies.

Recommendation 5.10

Apart from life, TPD and income protection insurance, no other type of insurance (for example trauma insurance) should be permitted to be paid for by members through their superannuation and any existing policies outside those categories should be phased out.

6 COMPETITION IN THE GROUP RISK INSURANCE MARKET

APRA data indicate that the annual cost of life and TPD insurance exceeds $3B for large APRA funds.[12]

As trustees act on behalf of members, there appears to be a precondition for effective competition between insurers for group policies. Tendering of insurance arrangements has fostered competition between insurers for superannuation business. Although experience differs between funds, it would appear that trustees can buy insurance at a competitive price for members.

However, over the six years to June 2009, the ratio of proceeds (that is, proceeds of claims paid to super funds) to net premiums for all funds averaged around 43 per cent (proceeds ratio). This means that about 43 cents was paid to super funds in satisfaction of claims for every $1.00 of premium paid.

In table 5.3 below, a sector with a higher proceeds ratio means that an average fund in that sector received more insurance proceeds per dollar of premium than an average fund in a sector with a lower ratio. Of course, proceeds on insurance policies may not be attributable to the premiums paid in that financial year or, when payments are made in the form of an income stream rather than a lump sum, reflect the full extent of payments attributable to claims arising in that year. In addition, premiums are used to cover administration, overheads, commissions and claims-handling costs, as well as funding reinsurance cover. Therefore, the proceeds ratio is not a measure of profitability, but it is an indicator of the policy's value to the policyholder.

IFSA's submission noted that a review of 13 insurance companies, found a ratio of 75.8 per cent on net premiums to policy payments on group life policies.[13] IFSA calculated net premiums after all fees, commissions, expenses and an allowance for profit were deducted from the gross premium. Also, claims were adjusted to take account of claims that had been incurred, but not yet reported, as some claims can take several years to finalise.

Even allowing for these adjustments, there is still a significant gap between net premiums and policy payments.

The Panel notes that some trustees have an arrangement with their insurer for a rebate of premiums so that the proceeds ratio on the group policy does not fall below 80 per cent. This approach, if more widely adopted, would appear superior to the outcomes currently experienced by most superannuation funds according to the IFSA data.

Table 5.3: Ratio of proceeds to net premiums by fund type[14]

	June 04	June 05	June 06	June 07	June 08	June 09
	$m	$m	$m	$m	$m	$m
ALL FUNDS						
Total proceeds on insurance policies ($m)	619.0	632.0	730.0	912.0	1069.0	1333.0
Net premiums ($m)	1322.0	1507.0	1755.0	2117.0	2458.0	3098.0
Ratio of proceeds to net premiums (%)	46.8	41.9	41.6	43.1	43.5	43.0
BY FUNCTIONAL CLASSIFICATION						
Corporate						
Total proceeds on insurance policies ($m)	77.0	70.0	55.0	68.0	66.0	65.0
Net premiums ($m)	127.0	111.0	96.0	115.0	128.0	111.0
Ratio of proceeds to net premiums (%)	60.6	63.1	57.3	59.1	51.6	58.6
Industry						
Total proceeds on insurance policies ($m)	222.0	231.0	266.0	354.0	464.0	591.0
Net premiums ($m)	380.0	472.0	536.0	720.0	886.0	1145.0
Ratio of proceeds to net premiums (%)	58.4	48.9	49.6	49.2	52.4	51.6
Public sector						
Total proceeds on insurance policies ($m)	8.0	9.0	20.0	17.0	22.0	63.0
Net premiums ($m)	12.0	12.0	64.0	72.0	133.0	228.0
Ratio of proceeds to net premiums (%)	66.7	75.0	31.3	23.6	16.5	27.6
Retail						
Total proceeds on insurance policies ($m)	312.0	322.0	389.0	474.0	517.0	615.0
Net premiums ($m)	803.0	911.0	1060.0	1211.0	1312.0	1614.0
Ratio of proceeds to net premiums (%)	38.9	35.3	36.7	39.1	39.4	38.1

Source: APRA.

The ratio of insurance income received to premiums paid is very different between industry sectors. There is also marked disparity within sectors in the level of premium charged to secure a particular level of life cover (see table 5.4).

Table 5.4: Annual death & TPD premiums ($) for $300,000 cover[15]

White Collar	Male 30	Male 40	Male 50	Female 30	Female 40	Female 50
Industry funds	193	266	672	178	251	631
Public sector funds	184	293	800	175	263	678
Retail funds	251	378	1,081	195	329	935
Overall Median	218	322	840	178	295	758
Blue Collar	Male 30	Male 40	Male 50	Female 30	Female 40	Female 50
Industry funds	266	358	895	234	356	895
Public sector funds	215	355	1,040	198	355	966
Retail funds	362	518	1,583	271	476	1,362
Overall Median	**311**	**456**	**1,162**	**240**	**414**	**1,068**

7 DISCLOSURE OF INSURANCE OFFERINGS

When a member changes super funds (either by choice or change of employment), they are no longer covered by the previous fund's policy and might start cover in the new fund on quite different terms. The quality and extent of insurance cover is often at the bottom of the list of reasons surrounding a fund change (even with advice) and is often not thought about at all. This would be acceptable if it did not potentially have negative consequences for members who can find themselves without the same level of insurance (because they don't meet requirements imposed by their new fund) or paying significantly higher premiums.

The different ways trustees disclose insurance premiums makes it almost impossible for members to compare insurance offerings and costing between funds and to find the fund that offers the best insurance for them. Chant West, recently identified that:

> *"Insurance is the worst disclosed area in superannuation. It is almost impossible for the layman — and difficult even for the expert — to compare one fund's insurance offering with another's. And some funds do not even publish their insurance premiums."*[16]

For this reason, the Panel sees advantages in having consistent and comparable insurance information between superannuation products. A standardised approach to disclosure of insurance features and premiums is required.

Transparency and comparability could be improved by requiring trustees to publish on their website the terms and conditions of insurance policies they offer, together with a plain-English explanation. In effect, the policy terms and conditions are the 'product' that members receive. By requiring this disclosure, members could compare the product they currently receive with that of any prospective fund.

Where there are substantial differences in premiums according to age; gender; whether blue or white collar employment; whether or not the member is a smoker; frequency of premium payment; and type of fund,[17] this information is crucial to the effective disclosure of the insurance 'product'. However, most group policies have automatic acceptance limits and so this information is not relevant.

Trustees should also be required to disclose the proportion of the fund's TPD claims that are successful on a basis to be determined after consultation with industry. The rate of success is one measure of the quality of the insurance cover that the member receives.

Recommendation 5.11

Trustees of large APRA funds should be required to publish on their websites the terms and conditions applicable to each type of insurance offered by the fund, along with other information relevant to members, including:

(a) a plain English explanation of the policy terms;

(b) premium tables showing the gross premium charged for each category of member (if relevant) at each $1,000 of cover at current age with a standard frequency of payment. Any additional cost associated with the insurance should be noted as part of this disclosure; and

(c) TPD claim success rate on a basis to be determined after consultation with the industry.

Disclosure could be further enhanced by requiring trustees to publish the fund's ratio of proceeds to net premiums for each type of insurance offered. This could significantly add to competition in the market for group risk insurance as trustees would seek to lift this ratio either through lower premiums, refund arrangements or improved policy terms and conditions. Ultimately, it may provide added incentive for trustees to seek to merge to secure scale, partly in order to achieve better insurance outcomes for members. However, the Panel sees this extended disclosure as a matter for trustees to determine.

8 INSURANCE AND FINANCIAL ADVICE

8.1 Commissions

There is widespread agreement that Australians generally are under-insured.[18] It has been commented that insurance is generally sold, rather than bought, and that widespread under-insurance means that measures to restrict incentives for the sale of life insurance should therefore be considered with caution.[19] In the *Future of Financial Advice* reforms, the Government indicated that it would consult further about whether to extend the ban on commissions to risk insurance (including group risk insurance). This was because insurance has different features from investment products, including the fact that, unlike superannuation, there are no investment funds which might be used to pay for advice. Therefore, concerns about affordability and the potential for under-insurance needed to be explored in this context.[20]

Group risk insurance is bought by the trustee on behalf of members, and offered by that trustee to its members. In other words, superannuation provides an ideal distribution mechanism for insurance. In this context, an adviser can help members in the composition and level of cover that they should have, but if the member receives no advice, they are still likely to be insured through default opt-out coverage. In fact, advice on insurance offered by the trustee could be provided through intra-fund advice, which all MySuper trustees will be required to have available.

The Panel considers that questions of affordability in the context of group life and TPD insurance are of less relevance than may be the case with individually acquired insurance, in that the trustee arranges the insurance, and the member's superannuation balance is available to pay premiums. At the same time, the Panel notes that in the 12 months to December 2009, commissions paid by life insurers for the acquisition and maintenance of policies amounted to $2.09B, compared with $3.8B in meeting death and disability claims.[21] While these figures relate to products both within and outside the superannuation system, it is clear that commissions represent a major expense for life insurers, and by implication for superannuation fund members.

A number of submissions supported banning commissions.[22] The Panel agrees with these views. Additionally, it believes that insurance commissions should be prohibited in respect of all superannuation products regardless of whether the insurance cover is a default cover or not. The Panel is also concerned that allowing commission-based payments for insurance would mean that financial planners could still be conflicted in giving their superannuation advice.

Recommendation 5.12

Up-front and trailing commissions and similar payments should be prohibited in respect of any insurance offered to any superannuation entity, including to SMSFs, regardless of rules on commissions that might apply outside superannuation.

8.2 Intra-fund advice

Advice on insurance will be important for members who have significant family and financial commitments. This arises typically in early middle age and evolves with the number of dependants and paying down financial commitments such as the mortgage on the family home. These matters turn on individual circumstances and, even where addressed, people might need to revisit these issues and their choices as they age and their circumstances change.

Superannuation funds can help meet this need through intra-fund advice and the Panel believes that intra-fund advice should be tailored to meet this need, among the other advice needs of members. As part of the Panel's recommendations, MySuper products would be required to have an intra-fund advice facility. Further, as MySuper members are least likely to give consideration to their insurance needs, the Panel considers MySuper funds should proactively engage with members about their level of insurance coverage within the fund. This should be at appropriate times; for instance, trustees could contact members at age 35 and then at such intervals as it thought necessary.

Recommendation 5.13

MySuper trustees should pro-actively offer intra-fund advice to members in relation to their insurance in MySuper.

9 DEATH BENEFIT NOMINATIONS

Trustees generally have the responsibility, in accordance with their trust deed, to determine who receives the benefits of life insurance policies in the case of death of a covered member. The scope

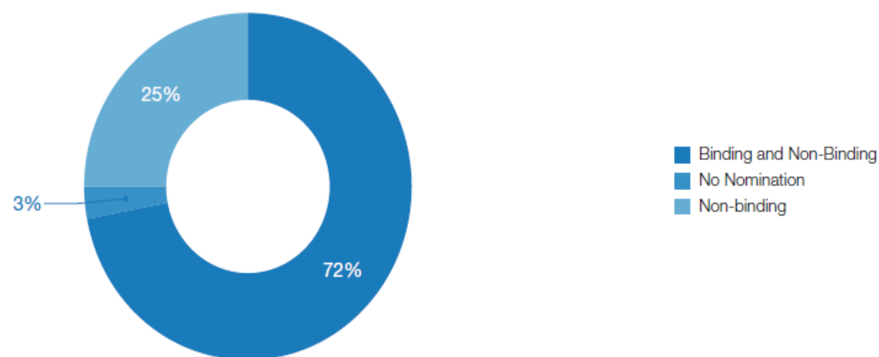
for trustee discretion to determine the beneficiary may be limited by the trust deed for the fund. For example, a trust deed might require benefits to be paid to the estate of the member.

Binding and non-binding death benefit nominations in effect allow a member to nominate their life insurance beneficiaries as the policy proceeds are part of the death benefit from the fund.

SuperRatings research (as set out in figure 5.1) shows that as at 30 June 2009, 72 per cent of funds offered both binding and non-binding death benefit nominations, 25 per cent offered non-binding nominations only and a small minority of 3 per cent did not offer death nominations to their members.[23]

Figure 5.1: Proportion of funds that accept death benefit nominations

Does the fund provide Death benefit nominations?



72% of funds provide binding Death benefit nominations to members which is a substantial increase from 2008. Only 3% do not allow any nomination.

Source: SuperRatings

A trustee has no discretion when the member has lodged a valid, binding death nomination and must pay benefits to the nominated beneficiaries, subject to them meeting the legislated eligibility criteria.

In practice, this means that binding death benefit nominations can lead to a result that is inequitable because the circumstances of the member and the beneficiaries change after the binding death benefit nomination is lodged with the trustee. Nominations can be changed or revoked by the member. Currently, binding nominations must be reconfirmed every three years in order to ameliorate the risk of inequitable outcomes due to a change in circumstances.

Binding death nominations are a useful tool to align the payment of death benefits with the preferences of the member. However, the current rules can lead to unintended outcomes where trustees are bound by death nominations that have not been changed to reflect changes in the member’s circumstances, such as those resulting from divorce. The Panel believes that binding death nominations should be invalidated when there are intervening circumstances. The current system used by States and Territories could be looked to for guidance and then an appropriate amendment made to the SIS Act.

Recommendation 5.14

The SIS Act should be amended so that binding death nominations would be invalidated when certain 'life events' occur in respect of the member. The current systems used by States and Territories under which testamentary dispositions are invalidated could be used as guidance for creating a single national model.

If the change in recommendation 5.14 is made to the existing rules, the Panel considers that the requirement for reconfirmation of binding death nominations could be extended to five years.

Recommendation 5.15

Subject to recommendation 5.14 being implemented, the SIS Act should be amended so that binding death benefit nominations only have to be reconfirmed every five years.

10 SELF-INSURANCE

Some funds are currently allowed to self-insure death and TPD benefits. Most of the funds that do so are non-public offer defined benefit funds or defined benefit sub-plans within public offer funds.

The main argument for allowing funds to self-insure is that the profit margin that would otherwise flow to external insurers could be 'internalised' by the fund, thereby reducing the cost of insurance for members. Another rationale is to support particular benefits offered by some funds that are not generally available from the commercial insurance providers — for example, payment of TPD benefits as inflation-protected income streams, rather than as one-off lump sums.

However, the risks associated with self-insurance are high, especially as non-public offer fund trustees are not necessarily capitalised. For example, in a worst case scenario, if the insurance reserves of a fund were insufficient to meet claims, any shortfall would generally have to be met from the fund. This means that the burden would fall on employers in the case of defined benefit funds or in accumulation funds, on the remaining members (depending on the terms of the trust deed).

Prudential requirements imposed on authorised life insurers are an important safeguard that ensure that reserved capital is sufficient and of appropriate quality to meet expected claims, having regard also to reinsurance and other risk management strategies.

Self-insurance arrangements that are not prudentially supervised could also create arbitrage opportunities to be exploited by members. The 30-day portability rules would provide scope for members to leave a self-insured fund if a large number of claims were anticipated (for example, in a catastrophic event such as a pandemic), which could result in a large-scale run of withdrawals.

In conclusion, the Panel is not convinced that the potential gains to members in reduced premiums would outweigh the risks of self-insurance.

Accordingly, in the case of non-public offer funds that are currently permitted by law to self-insure death and TPD benefits, the Panel is of the view that, after a suitable transition period, self-insurance

should no longer be allowed except in the case of defined benefit funds. The Panel's views on defined benefit funds are explained in chapter 6. With respect to a fund that has a particular definition of TPD in its trust deed for which external cover cannot currently be obtained, the Panel's recommendation regarding the harmonisation of the trust deed TPD definition with the insurance policy requirements (recommendation 5.8), should eliminate this problem.

Where self-insurance is permitted to continue, it must be subject to regular APRA monitoring.

Recommendation 5.16

After a suitable transition period, self-insurance of any fund benefits, including death and TPD benefits, should not be permitted in any large APRA fund except defined benefit funds (or sub-plans) that are currently allowed to self-insure.

ENDNOTES

1 Lifewise, Media Release, 30 April 2009, '$91,000 not enough to cover lost life – Australians encouraged to become Lifewise', <www.lifewise.org.au>.

2 IFF & AIST Member Insurance Research, 3 June 2008, <www.aist.asn.au/media/13079/sis_sweeneys.pdf>.

3 Watson N. (ed) 2010, HILDA User Manual – Release 8, Melbourne Institute of Applied Economic and Social Research, The University of Melbourne (available at <www.melbourneinstitute.com/hilda/statreport.html>, as mentioned in the Lifewise/Natsem Underinsurance Report, February 2010 available at <www.lifewise.org.au>.

4 Household, Income and Labour Dynamics in Australia (HILDA) Survey. The HILDA Project was initiated and is funded by the Australian Government Department of Families, Housing, Community Services and Indigenous Affairs (FaHCSIA) and is managed by the Melbourne Institute of Applied Economic and Social Research (Melbourne Institute).

5 Watson N. (ed) 2010, HILDA User Manual – Release 8, Melbourne Institute of Applied Economic and Social Research, The University of Melbourne (available at <www.melbourneinstitute.com/hilda/statreport.html>, as mentioned in the Lifewise/Natsem Underinsurance Report, February 2010 available at www.lifewise.org.au.

6 Superannuation Guarantee (Administration) Act 1992, Section 32C.

7 ASFA, Submission no. 320, p 5.

8 For example, Marita Wall, Submission no. 1.

9 ISN, Submission no. 386, p 15.

10 ASFA, Submission no. 320, p 2.

11 AIST, Submission no. 380, p 15.

12 APRA, Annual Superannuation Bulletin, June 2009.

13 IFSA, Submission no. 382, p 18.

14 APRA Annual Superannuation Bulletin 2007: Selected feature Death and Disability Insurance in Superannuation and APRA Annual Superannuation Bulletin 2009, table 8.

15 Chant West, Insurance in Superannuation, May 2010.

16 Chant West, Insurance in Superannuation, May 2010.

17 Chant West, Insurance in Superannuation, May 2010.

18 IFSA, 'Life Insurance Fast Facts', 3 August 2005, <www.ifsa.com.au>.

19 Money Management magazine, article, 'Regulators must proceed with caution on insurance commissions', <www.moneymanagement.com.au> viewed 6 May 2010.

20 Hon Chris Bowen, Minister for Financial Services, Superannuation and Corporate Law, 'The Future of Financial Advice', 26 April 2010.

21 APRA, 'Quarterly Life Insurance Performance', Table 1(e), December 2009.

22 ASFA, Submission no. 320, p 6.

23 SuperRatings (February 2010), 'Superannuation industry benchmark statistics for the period ending 30 June 2009', provided to the Super System Review.