23 September 2019

Division Head, Retirement Income Policy Division
The Treasury
Langton Crescent
PARKES ACT 2600

Email: superannuation@treasury.gov.au

Dear Sir/Madam,

Consultation Paper - Universal Terms for Insurance within MySuper

Thank you for the opportunity to participate in the consultation.

The Actuaries Institute ("the Institute") strongly supports the Government's objective to improve outcomes for superannuation members and increase their understanding of the default (automatic) insurance cover provided within MySuper funds. The actuarial profession possesses highly relevant technical skills and deep knowledge of the insurance and superannuation fields. The Institute believes the following commentary will assist Treasury's understanding of the complex issues surrounding the application of universal terms.

The design and pricing of insurance cover for MySuper members is necessarily a balancing act between cover terms, cover levels, premiums and sustainability. The Institute recognises the benefits to the standardisation of certain terms and definitions within MySuper group life policies. Due to our unique position in the insurance in superannuation industry, we would welcome the opportunity to work with Treasury to achieve these benefits for members.

However, we also recognise that care needs to be taken in the application of standardisation. Unless applied carefully and in a targeted fashion, establishing universal terms may lead to unintended consequences for many superannuation fund members. These could lead to significant price increases and/or downgrading of the level of default (automatic) cover available. Such a development could also stifle innovation, by creating competition on price alone which could lead to significant imbalance of insurance offerings between superannuation funds due to their different respective membership profiles.

Instead, we believe any new legislation or regulation should be framed to standardise some terms only and continue to permit insurance definitions that do not disproportionately constrain members' opportunity to derive benefits that are commensurate with the premiums being deducted from the member's account. Superannuation funds would then be required to introduce basic standard terms that are common to generic products, and highlight any differences from other standard terms, which would allow members to easily compare and contrast the benefits and features provided by funds.

More fundamentally, we believe any standardisation of terms and conditions for disability insurance in superannuation should not be undertaken in isolation of other disability sectors. We believe that consumer understanding would be significantly enhanced by standardisation of other disability terms across Workers Compensation and other state based statutory compensation scheme.

The following comments outline the Institute's perspective on the standardisation of terms, definitions and exclusions in insurance offered through default (automatic) MySuper products. We have highlighted circumstances where the objective to improve consumer outcomes may not necessarily be met by legislating universal terms. In those instances, we have suggested alternative measures that may achieve the Government's objectives.

We would be happy to discuss this feedback and answer any questions you may have.

Yours Sincerely

Nicolette Rubinsztein
President

Responses to consultation questions

The merits of setting standard terms and definitions

1. *What are the costs and benefits of standardisation of terms and definitions for default MySuper group life policies?*

The design and pricing of insurance cover for MySuper members is necessarily a balancing act between:

- ***Cover terms:*** providing appropriate insurance cover (based on fair and reasonable policy definitions and exclusions) that assists superannuation members and their families in times of greatest need,
- ***Cover levels:*** providing adequate levels of cover (i.e. sums insured) in order to meet basic insured needs,
- ***Premiums:*** charging premiums for cover which do not inappropriately erode superannuation balances (noting the existing voluntary insurance in Superannuation Code of Practice includes specific limits on premium levels relative to salaries),
- ***Sustainability:*** providing cover terms and pricing that are sustainable into the future.

This trade-off varies for different superannuation funds based on the different demographics and the risk profile of the fund membership. Therefore, we believe that legislation should continue to allow each trustee (with support from insurers) to design insurance cover that is suitable for the needs of the membership of its fund (and member cohorts within that fund) with few limitations. This would also have the benefit of not stifling innovation in designing cover terms.

The Institute believes there are **potential benefits** to the standardisation of some terms and definitions within MySuper group life policies. These benefits include:

- Improved comparability of insurance terms across funds, which may enable independent benchmarking and useful summarised information to be made available to members.
- Standardisation of terms should lead to clearer legal precedent on terms and definitions leading to a reduced volume of claim disputes, and better member experience for some individuals. This is particularly the case for the terms that relate to
  - when cover starts and ends;
  - whether pre-existing conditions are covered;
  - exclusions from cover; and
  - definition of allowable offsets for Income Protection benefits.

Depending on the type of universal terms legislated, including any minimum or maximum level of cover, the **likely consequences** may include:

- Premium increases for some superannuation funds or for certain cohorts of members (potentially conflicting with the objective of avoiding inappropriate erosion of member balances).

- Cover terms becoming more restrictive than currently provided (which may lead to a mismatch of expectations regarding the circumstances in which a member is covered).
- Default cover levels reducing to a level that becomes of little value to some members (where a reduction in cover is implemented instead of a premium increase in the event that standardising terms lead to a premium increase).
- Reduced abilities for trustees and insurers to innovate and develop new products, terms and definitions to better cater for the needs of the members of any particular fund.
- Stifling innovation around product terms and premium structures. This could lead to a significant imbalance of insurance offerings between superannuation trustees due to their respective membership profiles.
- The need to grandfather current terms and conditions and cover levels for existing members who would otherwise cease to have cover or have their cover reduced, which may create complex insurance and administration arrangements.

Example 1

A superannuation fund with a large "blue collar" member base has a TPD definition with a more restrictive definition.

The fund moves to a less restrictive TPD definition under universal terms placing upwards pressure on pricing. The fund, wanting to maintain the overall insurance price to members (considering erosion of balance concerns under the Insurance in Super Voluntary Code), reduces the benefit amount for members.

In this example, the above consequences may outweigh the benefits of standardising the TPD definition.

2. *What terms and definitions would benefit from standardisation? Are there particular terms/definitions where the case for standardisation is stronger or should be prioritised?*

As outlined later in our response to Questions 11 and 12, we believe the focus of any new legislation or regulation should be framed to standardise some terms only, and continue to permit insurance definitions that do not disproportionately constrain members' opportunity to derive benefits that are commensurate with the premiums being deducted from the members' accounts.

Another approach would be to introduce basic standard terms (in particular for the terms that relate to when cover starts and ends, whether pre-existing conditions are covered and what is excluded from cover) that allow members to easily contrast the benefits and features provided by funds and funds are required to explicitly state where they deviate from standard terms. This would still enable tailoring at fund level but improve the ability of members to understand the cover that is being provided and allow innovation to continue.

We believe any standardisation of terms and conditions for disability insurance in superannuation should not be undertaken in isolation of other disability sectors. We believe that consumer understanding would be significantly enhanced by standardisation of other disability terms across Workers Compensation and other state based statutory compensation schemes.

3. *Should trustees be permitted to offer TPD insurances that differ from the definition of 'permanent incapacity' in the SIS Act? Is the current legislated definition of 'permanent incapacity' an appropriate standard definition of TPD?*

As outlined below in our response to Question 4, there are instances where varying the definition of TPD from that in the SIS Act can lead to positive outcomes for members. As such, we believe that legislation should continue to allow each trustee (with support from insurers) to design insurance cover that is suitable for the needs of the membership of its fund with few limitations.

4. *Should the definition of TPD allow for rehabilitation or return to work initiatives? Why/Why not?*

Yes, the definition of TPD should allow for rehabilitation or return to work initiatives for two main reasons:

- Rehabilitation and return to work initiatives could assist with an individual member's overall well-being and recovery.
- Any positive impact of rehabilitation and return to work initiative could reduce TPD claims and therefore reduce premiums, improving the overall affordability/sustainability of insurance in super.

5. *Is there a need for universal insurance exclusions in MySuper products? Why/Why not? If yes, should exclusions be standardised across all types of insurance provided within MySuper products? What standardised exclusions would deliver the greatest benefit to consumers?*

Whilst the standardisation of wording of common exclusions may offer some benefit in terms of members' understanding of their cover, there remains a need for some exclusions to be applied to some members and not others. Commonly, exclusions (e.g. pre-existing conditions) are used to reduce the impact of anti-selection and to cap the insurance exposure on claim costs and therefore member premiums. Anti-selection refers to, for example, a member who is already of ill health joining a fund specifically to obtain insurance cover and make a subsequent claim.

However, standardisation on its own will not be sufficient to ensure member awareness of exclusions. Therefore, it is important to ensure clear and frequent disclosures are provided to members on exclusions.

6. *What lead time would be required for the industry to implement standardised terms, definitions and exclusions if this reform was implemented?*

Defining an appropriate set of terms and conditions to apply to various member cohorts across all MySuper superannuation funds need to be carefully and thoroughly considered.

We note that implementing any change in terms simultaneously across the entire industry will cause strain on assessing the impacts of new terms to pricing. Without enough time to thoroughly consider the implications of changes in cover terms, there is a risk of sub-optimal outcomes for members in relation to insurance pricing and cover terms. Therefore, we suggest that any implementation timelines recognise this risk.

Any implementation of universal terms should be considered in light of other changes to the Insurance in Superannuation industry, including but not limited to the Protecting Your Super Legislation and the Insurance in Super Voluntary Code. Any unintended conflicts (e.g. the funds' premium rate becomes higher than the 1% cap as outlined in the ISWG code) will need to be addressed before implementation.

If this reform was implemented, the following elements of implementation would all require a considerable amount of time to ensure a smooth transition:

- Clarification on the reform wordings (i.e. which insurance is in and out of scope for the proposed change – automatic cover through Group contracts vs. underwritten cover on an Individual basis);
- Repricing of premium rates to reflect any changes to existing terms;
- Consideration of implications of customer behaviour stemming from changes to terms and/or premium rates;
- Consideration relating to grandfathering of existing terms;
- Refresh of policy documents and disclosure documents;
- Communication and engagement with members impacted;
- Changes to administration systems, on-line insurance portals and forms; and
- Training staff and changes to systems for the new standards.

This implementation timetable is exacerbated if all funds need to make changes at the same time creating resourcing significant issues for a relatively small pool of insurers and administrators. We would recommend a transition window to implement any of the proposed changes of 42 months from finalisation of the new regime, to allow funds to migrate to the new basis upon expiry of any existing guaranteed insurance arrangements. This would also avoid placing an unreasonable (and highly risky) workload on the industry to try to reprice the entire market in a compressed period.

Impact on premiums

7. *To what extent would standardising terms, definitions and exclusions across MySuper products impact the price of premiums?*

It is difficult to determine the impact on premiums without a specific set of proposals for the standardisation of terms, definitions and/or exclusions.

However, given the variation in terms and levels of cover currently available in the market, it is apparent that the impacts will vary considerably among superannuation funds, and among cohorts within superannuation funds.

Premiums are likely to increase if standardised terms and the level of cover available are made more liberal or generous than the current cover available to a certain cohort of members. Conversely, premiums may decrease if terms are tightened or cover is effectively reduced or capped compared to what is currently provided.

It is likely that any proposal to standardise terms will see some members experience premium increases and other members experience premium decreases and the extent of these changes may be significant at an individual member level but will ultimately depend on the proposed standardisation of terms, definitions and/or exclusions.

A premium increase is not always solely an adequate solution within an insurance pool. As a result of standardising terms, definitions and exclusions, some insurance pools may become unsustainable, in a way that will not be able to be resolved by a premium increase. This could see cohorts like high risk or heavy manual occupations, or casual and contract employees left without default cover.

8. *Would the impact on premiums outweigh the benefits of standardising the definition of TPD, or other definitions, terms and exclusions?*

Assuming no change to the current cover amount, the cohorts of members for whom premiums are most likely to increase substantially as a result of a proposal to move to standardised terms are those for whom cover is currently relatively restrictive. An increase in premiums for these members does not necessarily align to the willingness or ability of these members to pay additional premiums. For example, a member in a high-risk occupation may experience a substantial premium increase when moving to more favourable terms, but this premium increase may see a significant proportion of superannuation contributions go towards funding the cost of insurance cover.

The impact on premiums could therefore conceivably outweigh the benefits of standardising terms, definitions and/or exclusions where there is a direct pricing impact.

However, some standardisation in terminology (not definitions) such as the terminology for "Limited Cover/New Events Cover" or "Total and Temporary Disability/Income Protection/Salary Continuance Insurance/Group Salary Continuance" will have no pricing impact.

9. *How could the impact on the price of premiums be mitigated, without incentivising the creation of 'junk insurance policies'?*

Different levels of cover and different benefit terms have evolved out of trustees seeking to act in member best interests and make appropriate decisions regarding the trade-offs between benefit terms, cover levels and premiums for the various cohorts of members in their funds. Trustees are also weighing up these trade-offs in light of new requirements to ensure that premiums do not unnecessarily erode members' account balances, including assessing the appropriateness of the benefit design to consider and take into account whether there is any age cross-subsidies in premiums, in general and at a cohort level. This will improve members' comparison across different funds.

Additional constraints imposed by the standardisation of terms, definitions and/or exclusions may make managing these trade-offs across the spectrum of different member cohorts even more difficult.

Instead, we believe the focus of any new legislation or regulation should be on producing insurance definitions or terms that do not disproportionately constrain members' opportunity to derive benefits that are commensurate with the premiums being deducted from the members' accounts. Such measures may take the form of a specific set of TPD definitions that are 'approved' for trustees to choose with certain member cohorts. The set of 'approved' TPD definitions may differ between different cohorts of members in order to reflect their risk characteristics. In other words, this would permit a relatively more restrictive TPD definition to be used, but only for cohorts of members which present a significantly higher risk of claim and only if the likelihood of claim remains reasonably proportionate to the premiums payable.

10. *If terms, definitions and exclusions for MySuper products were standardised, how long would repricing of premiums take to flow through to members?*

We would expect that estimates of the impact of the changes would be made by insurers and applied from the effective date of the standardised terms, definitions and/or exclusions.

As discussed above in our response to Question 6, our expectation is that a significant implementation period would apply for any standardisation measures to take effect, such that insurers may undertake detailed and robust repricing exercises and trustees can make informed decisions about the trade-off of cover levels and cost of insurance.

However, actual pricing impacts will only become known over time. As an example, TPD insurance is a long-duration liability. It could take years for the full effect of the product definition changes to fully work through the claims experience – so we estimate that the full impact on any pricings change would arise over 3-5 years as the impacts of the changes become more certain.

<u>Improving consumers' understanding of insurance in superannuation</u>

11. *To what extent would standardised terms, definitions and exclusions for MySuper products improve consumer understanding of insurance in superannuation? What particular changes would deliver the greatest benefits to consumer outcomes?*

12. *Are there other ways to improve consumer understanding of insurance in superannuation without standardising terms/definitions/exclusions?*

The responses to questions 11 and 12 are combined:

We believe that there is merit in legislation placing some limitations or criteria on insurance terms that are provided on a default basis to MySuper members who may not sufficiently understand their insurance choices. This may take the form of:

- A specific set of TPD definitions that are 'approved' for trustees to choose with certain member cohorts. Each definition would be labelled in a consistent plain-language format per the Code of Practice. We expect that this would assist in providing trustees the flexibility to tailor default cover to their membership, whilst providing members some protection against inappropriate default cover terms.
- The use of a minimum standard definition in which trustees could consider a more expansive definition for their membership base as appropriate.

- The use of standard basic terms with any deviations from standard explicitly.

The Institute believes that are there are alternatives to improve consumer understanding of insurance in superannuation which include:

- Simpler definitions in disclosure documents and policy documents.
- Education and communication materials that are tailored to different demographics.
- Proactive engagement by the superannuation trustees to reach out to members about their insurance covers.

<u>Merits of prescribing minimum, maximum or set levels of cover</u>

13. *Should maximum, minimum or set levels of cover be prescribed for MySuper products? Why/Why not? Should these apply to all types of insurance provided within MySuper products?*
14. *What factors should be taken into account if a minimum, maximum or set level of cover were to be prescribed?*
15. *Are there any unintended consequences of mandating a minimum, maximum or set level of cover for MySuper products?*

Responses to questions 13, 14 and 15 are combined:

There should not be a need for levels of cover to be further prescribed within MySuper as the demographic profile of each fund can be materially different.

- Prescribing and implementing a set level of cover will be challenging as it faces issues (outlined below) both relevant in setting minimum and maximum levels of cover.
- The prescribed minimum and maximums would need to be varied according to age as it is commonly recognised that Death and TPD insurance needs vary by age. Without such variations, it would lead to significant over-insurance at younger and older ages and significant under-insurance at other ages.
- Having minimum levels too high may result in excessive level of premium leading to further account balance erosions.
- To address minimum levels being too high, insurers may then seek to raise entry standards through tighter underwriting or stricter risk controls, meaning a section of the membership will miss out on a more modest cover level.
- Having maximum levels too low may result in the insurance cover not meeting the needs of members.
- If the range (minimum to maximum) is set to be too large, the minimum and maximum levels would then become irrelevant in standardising default cover levels.
- Trustees try to set cover levels carefully allowing for their members’ salary levels, locations, occupations, insurance needs. Minimum or maximum levels of cover should not over-ride these fundamental settings.

- Trustees may also set low levels of TPD with longer Income Protection benefit periods to provide a needs-based approach to disability benefits. Minimum levels of TPD must be set in conjunction with consideration of the level and duration of Income Protection benefits.
- Where current levels of insurance are higher for existing members, there would need to be grandfathering to protect current cover levels, especially if these covers have been underwritten.

Superannuation Trustees are required under section 52(7) of the SIS Act to make decisions regarding the appropriate level of cover for their members, balancing levels of cover levels and premium.

Setting boundaries to the level of insurance cover would further complicate and limit the ability of trustees to comply with the SIS Act and the ISWG Code.