26 April 2019

Division Head
Retirement Income Policy Division
Treasury
Langton Cres
Parkes ACT 2600

By email: superannuation@treasury.gov.au

Dear Sir / Madam,

Re: Universal terms for insurance within MySuper

AustralianSuper is pleased to make a submission to Treasury on its consultation paper *Universal terms for insurance within MySuper*.

About AustralianSuper

As you know, AustralianSuper is Australia's largest superannuation fund and is run only to benefit its members. The fund has over 2.2 million members and manages over $150 billion of members' assets. Our sole focus is to provide the best possible retirement outcomes for our members. AustralianSuper is responsible for investing the superannuation savings of more than 10% of Australia's workforce, and we take seriously our responsibility to act in the best interests of our members in this process.

AustralianSuper works hard to maintain appropriate, value for money insurance for members, aligned with their needs and ensuring their retirement outcomes are not compromised. We make no profit from insurance – the premiums we charge members are used entirely to benefit insured members of the Fund.

Key Points

- AustralianSuper is supportive of key universal insurance terms in MySuper products. Insurance within MySuper products is essentially a default product provided within a default product. As such the onus is on the provider to offer a product that meets members' insurance needs with as little unexpected experience as possible for members.
- Universal insurance terms within MySuper products need to have a level of flexibility to promote sustainability and allow universal coverage.
- Universal insurance terms for disability cover should not be constrained to terms *within* total and permanent disablement. There is significant benefit for consumers in having income protection insurance provided within MySuper products (either replacing or complementing TPD).

The following submission outlines AustralianSuper's view on the application of universal insurance terms for MySuper products, and an explanation of the reasons for that view. Answers to Treasury's questions are contained in attachment 1 to this submission.

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AustralianSuper's opinion on universal terms

1. AustralianSuper is supportive of key universal insurance terms in MySuper products. We believe the main benefit to members from universal terms is industry-wide embedding of good practice at the detailed level; thereby avoiding issues raised at the Royal Commission such as members paying premiums but effectively not being able to claim.

2. Introducing universal terms would be difficult but achievable with the right balance between:
   - Consultation with industry;
   - Legislative underpin to make it happen; and
   - Appropriate funding and support for this work[1].

3. We believe the introduction of universal terms would need to come with sufficient safeguards and flexibility to ensure that insurance could still be provided on a near universal basis to the working population even under a significant adverse scenario (e.g. a 1 in 200 year adverse claims experience). This may include:
   - Not being severely restrictive on *all* of the following: cost of insurance premiums; insurance terms; and minimum amounts of insurance cover. The danger is that if claims increase significantly then, for insurance to remain viable, either insurance premiums need to increase, claims need to reduce (potentially by variations in insurance terms); or insurance cover needs to reduce. If *all* these are severely restricted then the only possible course of action may be for insurers to cease offering cover to some or all segments of the market.
   - The flexibility to review standardised terms to withstand 'shocks' and evolution in the insurance environment.
   - Sufficient flexibility to allow exemptions for certain areas; for example a standardised disability definition may not be appropriate for full time professional athletes.

4. AustralianSuper's opinion is that universal terms need not be considered within the constraints of death and Total and Permanent Disability (TPD) cover. In particular, we believe income protection is far more effective in meeting members' disability needs while promoting a sustainable insurance offering with affordable premiums for the membership as a whole. This is a good opportunity and forum to consider whether TPD is the right cover to be mandated within MySuper or whether income protection is more appropriate.

Universal terms – a general discussion

<u>Support for universal terms</u>

AustralianSuper agrees with Commissioner Hayne's sentiments that "…there is merit in considering the extent to which insurance within MySuper funds can be standardised, or at least standardised in key respects."[2]

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[1] Often industry-wide initiatives are driven by volunteer committees so it is important that introduction of universal terms be supported by dedicated and funded project resources, with industry providing input as subject matter experts.
[2] FSRC Final Report, 323.

We believe the main benefit from standardised terms is industry-wide embedding of good practice at the detailed level; thereby avoiding issues raised at the Royal Commission such as members paying premiums but effectively not being able to claim (for example due to their employment status).

Standardised terms would provide confidence to members that they have insurance with terms complying with legislation, without the need to research the detailed insurance terms themselves.

In our view it is unlikely that universal terms would significantly lead to enhanced member understanding – insurance policy documents will still likely contain over 50 pages of insurance terms, it is just that key terms may be standardised. Our research has indicated that member engagement in insurance, beyond simply knowing what type of cover they have, is fairly limited and this is unlikely to change whether or not the 50 pages of insurance terms are standardised or not.

<u>Safeguards for universal terms</u>

We suggest that, in standardising terms, the underlying principle of insurance be protected, whereby a pool of healthy members pays sufficient premiums to support claim payments for those unfortunate enough to die or become disabled. Only 1 in 200 insured members claims each year (approximately). Many insurance terms are introduced to support this underlying principle and avoid the situation whereby members wait until they are on the verge of claiming before taking out cover. For example, at AustralianSuper, new members may increase their death and TPD cover to $600,000 within 120 days of joining without evidence of health but subject to the important term of them being unable to claim on a pre-existing condition for the next two years.

Also supporting the principle of insurance is the sustainability of the insurer. For the insurer to be sustainable:

Premiums > Claims and Expenses – by a small margin to cover the insurer's capital costs and profit margin.

Consider a situation where claims increase dramatically and put the above equation out of balance, such as occurred in the 2013/14 industry-wide disability crisis. In this situation:

Claims and Expenses > Premiums and the insurer makes losses.

The following actions are available to address the situation:

Action	Constraint
Increase premiums	The extent of any premium increase is constrained by the Insurance in Superannuation Voluntary Code of Practice ('Code'), which requires that insurance premiums must be capped at 1% of members' salaries. Both the Royal Commission and the Productivity Commission have recommended that elements of the Code be legislated as mandatory.
Strengthen Insurance Terms	For example, AustralianSuper strengthened our disability definitions in 2014 in response to the industry-wide disability crisis. However universal terms may act as a constraint on the ability to do this in future.
Reduce cover	This may be the only available response to an increase in claims if the constraints of the 1% of salary premium cap and universal terms are enforceable and onerous. However this action may be constrained if

	minimum thresholds for cover are increased significantly as suggested by the Royal Commission.

As a result of the various constraints on the ability to increase premiums, strengthen insurance terms or reduce cover, an unlikely but possible outcome is insurers withdrawing capacity from some or all segments of the market in response to adverse claims experience.

As such we suggest that:

- In standardising insurance terms, enough flexibility be retained to withstand adverse claims experience and 'shocks' and evolution in the insurance environment[3];
- The industry be further consulted in determining the *detail* of universal terms, perhaps via a similar forum that developed the Code; and
- There be sufficient flexibility to allow exemptions for certain areas; for example a standardised disability definition may not be appropriate for full time professional athletes.

We provide some initial suggestions within the questions section below about how such flexibility may be achieved.

<u>Universal terms for disability</u>

AustralianSuper's opinion is that universal terms need not be within the constraints of death and Total and Permanent Disability (TPD) cover. We believe income protection is far more effective than TPD in meeting members' disability needs while promoting a sustainable insurance offering with affordable premiums for the membership as a whole. Our reasoning is:

- Income protection delivers to members' needs. It pays members an income replacement benefit when a disability means they cannot work, regardless of whether this is permanent or not. Conversely, TPD will not pay a benefit even for a long term disability if it 'unlikely' to be permanent. And TPD will pay a large lump sum benefit if the disability is 'likely' to be permanent but turns out not to be; as mentioned in the Treasury consultation paper, one superannuation fund, upon surveying their TPD claimants found that 36 per cent returned to work after receiving a TPD payout.

  In reality, there is a continuum of severity and duration of disability, particularly in our evolving society where mental health disabilities are increasingly prevalent. TPD forces a point-in-time assessment of the likelihood of permanency, with significant and binary financial outcomes for the claimant.

- Income protection is a benefit design which facilitates rehabilitation, retraining and recovery, providing societal benefits to the disabled member, the wider membership (by way of sustainable premiums) and the community. Conversely TPD can provide a *financial* incentive to prove permanency of disability, which discourages rehabilitation and encourages dispute and litigation.

[3] For example, it is our view that the originally drafted Protecting Your Super legislation (which prohibited default insurance for account balances below $6,000) would have introduced characteristics of retail insurance into the market and would have required tighter elig bility terms to obtain cover.

If you have any further queries please do not hesitate to contact Richard Land, Head of Insurance Product on 0437 921 779, rland@australiansuper.com or Louise du Pre-Alba on 03 8648 3847, lduprealba@australiansuper.com.

Yours faithfully,

Richard Land

Richard Land
Head of Insurance Product

Attachment 1: Responses to Questions

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

   Benefits

   - Significant and widespread improvement in member outcomes from embedding good practice at the detailed level; thereby avoiding issues raised at the Royal Commission such as members paying premiums but effectively not being able to claim (for example due to their employment status).
   - Provision of comfort to members that they have insurance with terms complying with legislation at a detailed level, without the need to research the insurance terms themselves. Most members have insufficient time, expertise and inclination to research the various insurance terms in the market to determine their appropriateness, yet they have the right to effective cover without being experts.
   - Standard terms could assist in aligning claims practices across the industry.

   Costs

   - Significant investment in agreeing and implementing standardised terms across the industry that are fit-for-purpose for all funds with their own specific membership demographics and risk profiles and which do not lead to unintended consequences – this is much easier at the individual insurer and fund level. Every policy document, insurance guide and premium pricing would need to be revisited and re-issued.
   - Possible reduced flexibility to address a dramatic increase in claims (e.g. by reason of anti-selection) or 'shocks' to the insurance environment – as discussed above.
   - The 'free-rider' effect. There is little incentive for an insurer or superannuation fund to research enhanced risk controls to lead to more sustainable competitive premiums because, in order to implement these enhancements, they would need to lobby to have the standardised terms changed. In that scenario, all insurers and funds would benefit and the insurer or fund which performed the research would incur all the costs but share the benefits with competitors.
   - Ongoing maintenance of the standardised terms. In our view it is good practice to regularly review terms and conditions. This should be adequately resourced, and in the case of a centralised set of standardised terms, the logical reviewer would seem to be a regulator.

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?

This needs to carefully strike the balance between standardisation and flexibility.

There are benefits to members of standardising the following, in approximate order of priority:

- Eligibility for cover, including any minimum hours; any special requirements for casual or self-employed workers; and any ineligibility due to previous lump sum disability claims. The reason this is a high priority is that members may not realise they are ineligible until claims time.
- Differences in disability definitions based on employment status (permanent, casual, self-employed; unemployed, home duties) and hours of work. Again this is high priority because the stringency of the definition may vary due to these factors and members may not realise this until claim time.
- Use of pre-existing condition exclusions; terminology for these exclusions; and conditions under which pre-existing condition exclusions cease. Members may not be aware of these pre-existing condition exclusions until claim time.
- Other elements of disability definitions including requirements in relation to rehabilitation and retraining; and requirements to follow the advice and direction of a medical professional.
- Life expectancy period for terminal illness.
- Rules for cessation and reinstatement of cover (although this is being done by the Protecting Your Super legislation and the Code).
- Income offsets, recurring disabilities and pre-disability income definitions for income protection.

As discussed, members stand to benefit from standardisation of these terms as the terms can impact whether or not a member is covered and the member may not know this until claim time. Conversely these controls exist to support the sustainability of premiums to prevent members from waiting until they are on the verge of claiming before taking out cover and may need to be tailored to the risk profile of a fund's membership demographic and may need to adapt quickly to address emerging claims experience. As discussed, standardisation needs to strike an appropriate balance.

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?

Yes, trustees should be permitted to offer TPD insurances that differ from the definition of 'permanent incapacity' in the SIS Act. **However the TPD definition offered by trustees should not be more 'liberal' than the definition of 'permanent incapacity' in the SIS Act because this would lead to insured benefits becoming trapped inside the superannuation fund without being able to be released to members.**

No, the current legislated definition of 'permanent incapacity' is not appropriate. In particular:

- ‘*Unlikely* that the member will engage in gainful employment’ is insufficiently rigorous to qualify for a large disability lump sum and does not promote sustainability of insurance premiums paid by all members.
- The absence of a requirement for re-training does not reflect the modern day workplace where the nature of work is evolving and requiring re-skilling in the normal course of a working lifetime.
- There have been Court decisions which prompted changes to insurance TPD definitions to more closely align with the intention of TPD, which have not resulted in consequential changes to the definition of ‘permanent incapacity’ in the SIS Act.

Furthermore, we believe trustees should be permitted to offer forms of disability insurance other than TPD. Our view is that an income protection benefit better meets members’ disability needs because:

- Members have financial needs on disability whether or not the disability is permanent; and
- In reality there is a continuum of severity and permanency of disabilities and income replacement removes the anomaly whereby, for two very similar disabilities, one receives a substantial lump sum TPD benefit and the other does not.

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

Yes. Returning to good work is generally beneficial to the disabled member, the wider membership (through sustainability of affordable premiums) and the community. It is our view that it is reasonable to expect a claimant to undertake rehabilitation and return to work where reasonably possible.

Furthermore we feel that, regardless of the definition, TPD can provide a *financial* incentive to prove permanency of disability, which discourages rehabilitation and encourages dispute and litigation. As such we feel this consultation should think outside the confines of TPD. Income protection is a benefit design which facilitates rehabilitation, retraining and recovery.

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?

From the member’s perspective, standardised exclusions would likely lead to greater certainty about the level of coverage they enjoy under insurance in a MySuper product. It would make their choice of MySuper product clearer and easier to navigate, without that being clouded by issues relating to the probability of being able to make a claim on insurance.

Candidates for standardisation may include pre-existing condition exclusions, self-inflicted injuries and suicide.

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

   Indicatively, two years to consult on standardised terms and one year to implement. There is a significant amount of detail regarding insurance terms offered in the market and being relevant to various membership demographics.

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

   This would depend entirely on the nature and detail of the standardised terms – the "devil is in the detail". Well-constructed standardised terms which are fair and reasonable may have no impact on the price of premiums but this would also depend on the demographics of each fund's membership.

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

   Our view is that it is feasible to construct standardised TPD definitions that are fair and reasonable and lead to benefits to members without a significant impact on premiums for most funds.

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

   The impact of the price of premiums would be mitigated by introducing well-constructed standardised terms which are fair and reasonable to all parties.

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

    Pricing would flow through to members on the date the standardised terms, conditions and exclusions became effective.

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?

    As discussed, in our view it is unlikely that standardised terms would significantly lead to enhanced member understanding – insurance policy documents will still likely contain over 50 pages of insurance terms, it is just that key terms may be standardised.

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

    Plain language is important and there is a need to invest more in this to enhance the member experience.

It is worthwhile having an insurance communications strategy that maps out the member's insurance journey with the fund – from on-boarding to business-as-usual activities to claim and exit. Having a clear understanding of all the touchpoints and ways of engagement with the member opens the opportunity to divulge the right information that's easy to understand at the right time.

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?

If Society as a whole sees benefit in providing large scale insurance cover via superannuation then there is merit in prescribing a basic minimum level of cover to ensure that this occurs and that the environment is such that group insurance principles can apply (e.g. basic levels of cover being provided without underwriting or health evidence provided the member is in active employment).

However, as discussed, legislation should not be severely restrictive on *all* of the following: cost of insurance premiums; insurance terms; and minimum amounts of insurance cover. The danger is that if claims increase significantly then, for insurance to remain viable, either insurance premiums need to increase, claims need to reduce (potentially by variations in insurance terms); or insurance cover needs to reduce. If *all* these are severely restricted then the only possible course of action may be for insurers to cease offering cover to some or all segments of the market.

14. What factors should be taken into account if a minimum, maximum or set level of cover were to be prescribed?

Minimum default cover levels should be set at a relatively low level so as to maintain flexibility to withstand adverse claims experience and 'shocks' to the insurance environment, given that other responses to these situations are likely to be constrained by both the Code and legislation.

Age is an important factor in determining minimum levels of cover; for example:

- Very young members are unlikely to have dependents and therefore have less need for death insurance;
- Members aged in their 30s and 40s are likely to have a greater need for insurance; and
- Insurance for older members is less affordable and therefore more likely to lead to erosion of account balances.

15. Are there any unintended consequences of mandating a minimum, maximum or set level of cover for MySuper products?

As discussed, if the cost of cover (capped at 1% of salary by the Code), standardised terms, and the level of cover are all mandated then an unlikely but possible response to adverse claims experience or a 'shock' to the insurance environment is insurers withdrawing capacity from segments of the market.