CHARTERED ACCOUNTANTS™
AUSTRALIA + NEW ZEALAND

15 May 2019

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

Submitted via email to – superannuation@treasury.gov.au

Dear Sir/Madam

Universal terms for insurance within MySuper – Issues Paper

Thank you for the opportunity to contribute to the above consultation process.

We believe it is regrettable that the government intends to address specific findings of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry in relation to universal terms for insurance within MySuper investments without concomitantly considering the findings and recommendations of the Productivity Commission about life insurance matters in its inquiry report *Superannuation: Assessing Efficiency and Competitiveness*.

In addition as stated in previous submissions the legislative rules governing the payments of death benefits and other similar provisions have not been reviewed for many years and contain many practical complexities. We think it is beyond time for these to be thoroughly reviewed.

Before dealing with the specific questions contained in the Treasury issues paper, it is essential to understand the concept of insurance held by a superannuation fund:

Life Insurance is a valuable benefit and should be encouraged but within super funds it will always be complex

Chartered Accountants ANZ is of the view that life insurance is a very valuable product. We believe Winston Churchill's famous comment remains fundamentally true (although clearly it would need revising for life in the twenty first century):

> *"If I had my way, I would write the word 'insure' upon the door of every cottage and upon the blotting book of every public man, because I am convinced, for sacrifices so small, families and estates can be protected against catastrophes which would otherwise smash them up forever.*
>
> *"It is the duty to arrest the ghastly waste, not merely of human happiness, but national health and strength, which follows when, through the death of the*

Chartered Accountants Australia and New Zealand
33 Erskine Street, Sydney, NSW 2000
GPO Box 9985, Sydney NSW 2001 T +61 2 9290 1344

GAA Global Accounting Alliance
Chartered Accountants Worldwide

© Chartered Accountants Australia and New Zealand ABN 50 084 642 571 (CA ANZ). Formed in Australia. Members of CA ANZ are not liable for the debts and liabilities of CA ANZ.

> *breadwinner, the frail boat in which the family are embarked, founders and the women and children and the estates are left to struggle in the dark waters of a friendless world."*

Traditionally superannuation has been provided by an employer who designed a scheme to provide benefits for an employee and their family if employment, and therefore a reduction in household income, ceased for certain specified reasons typically retirement, death and permanent disablement. A good example of this is the death and disability benefits that have always been a feature of Commonwealth public sector defined benefit retirement schemes. The purchase of death and permanent disability life insurance policies in accumulation style schemes merely represented an evolution of these benefits in a different style of superannuation fund.

It is for this reason that death and disability insurances have been allowed within superannuation funds including in the original version of the *sole purpose test* (SPT) in the *Occupational Superannuation Standards Act 1987*, which codified rules the Australian Taxation Office had first issued in the 1970s, and the revised SPT in the *Superannuation Industry (Supervision) Act 1993*.

The purchase of life insurance within the superannuation system remains an extremely important feature of this system and it would be significantly weaker if these products could not be purchased by trustees.

It is certainly true that there are problems and complexities within the life insurance industry itself and how it inter-relates with the superannuation system. Indeed it is probably true that there is considerable room for improvement in product design and insurer behaviour as well as a great need to educate the community about how contracts for insurance work.

We appreciate the desire to simplify the superannuation system by seeking to codify standard types of benefits that can be provided by super funds offering MySuper or default compulsory employer contribution products. However we think there are two issues that this does not consider:

1. Product innovation in the life insurance market could be lost to the MySuper space if insurance product design features are hardwired in government legislation
2. Funds are governed by a range of documents especially their trust deed not just the provisions of the SIS Act.

Legally Complex Matters with No Industry wide Interpretation of Concepts and Terminology

It is obvious that many issues involving insurance within superannuation are deeply complex.

In no particular order they involve the following:

1. The fund's trust deed and other governing rules – as superannuation is an express trust and the super laws are often permissive, as opposed to obligatory, it is for all practical purposes essential that a super fund have a written trust deed – it is these documents which are arguably the most important in relation to operation of a fund including the provision to insurance.

   The reality is that if a super fund trustee wants to receive tax concessions then their trust deed cannot have rules that permit the payment or provision of benefits on a less strict basis than allowed under the super laws. A trust deed however can be, and in practice often are, more restrictive than the super laws. For example, a fund's trust deed may only permit a permanent incapacity benefit if

© Chartered Accountants Australia and New Zealand ABN 50 084 642 571 (CA ANZ). Formed in Australia. Members of CA ANZ are not liable for the debts and liabilities of CA ANZ.

a member is unlikely to ever be gainfully employed in any occupation which is a stricter definition than allowed in the super laws.

In many situations, fund trust deeds do not permit the payment of any insurance benefit unless an insurer has paid a relevant claim.

2. General trust law – for the sake of this submission we will include here Court developed trustee duties and also State/Territory Trustee Acts

3. The superannuation laws – this contains many areas impacting the provision of insurance through a super fund:

    a. Trustee covenants especially to act in a member's best interest

    b. Sole Purpose Test – we will not discuss all the details of this test; for now we will just note that the test permits super funds to provide a benefit on a member's death; to members if they have ceased any gainful employment due to ill health (whether physical or mental); or any other purpose approved by a regulator. It's important to note that the timeframe for the cessation of gainful employment is not defined.

    c. Approved conditions of release under preservation standards – that is, when benefits can be paid from the fund; for our purposes, there are four key rules:

        - Death – all a member's benefits – including any death insurance – can be paid to a member's legal personal representative or dependants or both
        - Terminal medical condition – all a member's benefits can be paid to the member if two registered medical practitioners – one of whom is a suitably qualified specialist – have certified that the person suffers from an illness or injury that is likely to result in the member's death within the next 24 months; it maybe that a member's benefits may include insurance proceeds as some insurers will pay a death benefit early if the insured suffers from a terminal illness
        - Permanent incapacity – all a member's benefits can be paid including any permanent incapacity insurances received by the fund; a benefit is payable if the trustee is reasonably satisfied that the member's physical or mental ill-health makes it unlikely that the member will engage in gainful employment for which the member is reasonably qualified by education, training or experience; this definition is often called a "similar occupation" definition; that is, a member cannot perform work which is similar to their current occupation
        - Temporary incapacity – this applies if mental or physical ill-health has caused the member to cease gainful employment however the ill-health is not considered to be permanent; this is often paid via income protection insurance; member financed and compulsory employer contributions plus earnings on these amounts cannot be paid out as part of this benefit however they could be used to purchase the income protection insurance

    d. How can benefits be paid? This will depend on what a super fund's trust deed states and the capability of administration systems, but the super laws permit the following:

        - Death – if a benefit is paid to the member's legal personal representative then the benefits must be paid as a lump sum; if paid to dependants then the benefits could be paid as two lump sums and/or multiple pensions

© Chartered Accountants Australia and New Zealand ABN 50 084 642 571 (CA ANZ). Formed in Australia. Members of CA ANZ are not liable for the debts and liabilities of CA ANZ.

- Terminal medical condition – benefits can be paid as one or more lump sums and/or one or more pensions
- Permanent incapacity – benefits can be paid as one or more lump sums and/or one or more pensions
- Temporary incapacity – benefits must be paid as a non-commutable income stream but only for the period of time the member cannot perform their pre-incapacity gainful employment

e. Who can receive those benefits – for death benefits it can be paid to the deceased legal personal representative (LPR) or their dependants; if paid to the LPR then it must be paid as lump sum; if paid to dependants then it can be paid with no more than two lump sums and any number of pensions. This is an area of great complexity and in need to considerable reform.

All other benefits are paid to the member.

4. Taxation considerations

a. Contributions – the funding of insurance premiums made by a super fund – for many superannuants the purchase of insurance via compulsory employer super contributions is cost effective because it permits the purchase of insurance without impacting after tax take-home salary (because compulsory employer super contributions are effectively deferred salary that often faces lower taxation than other remuneration such as taxable fringe benefits or take home salary)
b. Fund expenses – in many cases, super funds will receive tax deductions for insurance premiums or will receive a tax deduction for the future liability to pay a benefit; often temporary incapacity insurances will be deductible if the insurance period is for two years incapacity or a longer period if a super fund regulator or the Commissioner of Taxation has approved the period of time however we are unaware of any such approvals being granted
c. Benefit payments – in general the following tax rules apply:

- Death and terminal illness – lump sums

	Deceased at time of death	**Recipient's age**	**Taxation**
Member (terminal illness) or Dependants (death)	All ages	All ages	Tax-free
Non-dependants	All ages	All ages	Tax-free component – 0% Taxable component – Taxed element – 15% Taxable component – Untaxed element – 30%

- Death and terminal illness – pensions

© Chartered Accountants Australia and New Zealand ABN 50 084 642 571 (CA ANZ). Formed in Australia. Members of CA ANZ are not liable for the debts and liabilities of CA ANZ.

	Deceased at time of death	Recipient's age	Taxation
Member (terminal illness)	All ages	All ages	Tax-free
Dependant (death benefit)	Under 60	Below 60	Taxable component – marginal rates less 15% rebate Tax-free component – tax-free
		At least 60	All tax-free
	At least 60	All ages	All tax-free

- Permanent incapacity – lump sum

Age of permanently disabled member	Portion subject to PAYG withholding	Rate of withholding
Below preservation age	Whole amount	20%
At least preservation age to under age 60	Under $205,000 (2018/19 FY)	0%
	$205,000 (2018/19 FY) -> +	15%
At least age 60	Whole amount	0%
Please note that the Medicare levy will be payable whenever the tax rate is greater than 0%.		

- Permanent incapacity – pensions

The taxable component is taxed at normal marginal rates less a 15% tax offset if the recipient is aged under 60. The tax-free component is paid without any tax being deducted.

- Temporary incapacity benefits – fully assessable under normal marginal rates

5. Insurance Claims

In Appendix B we provide the typical claim process for a death benefit paid from a super fund involving insurance. A key point to understand is that the process can be further complicated if a re-insurer is also involved in determining the claim.

The primary job of the fund's trustee is to assess if a claim meets the terms of the fund's trust deed and other governing documents.

Clearly all these early access rules are complex. And an additional point of complexity is that there is no industry wide agreement about what all terms and conditions mean. This situation is unlikely to change even if standardized benefits are required by government fiat.

In addition most consumers are unlikely to concern themselves with all specific issues detailed here unless absolutely necessary.

© Chartered Accountants Australia and New Zealand ABN 50 084 642 571 (CA ANZ). Formed in Australia. Members of CA ANZ are not liable for the debts and liabilities of CA ANZ.

This submission does not address all the draft proposals contained in the above Treasury consultation paper. CA ANZ is a professional accounting body and many of our members are involved in the retirement income sector in many different roles including trustee, operational, product development, administration, finance, management reporting, audit and assurance and financial advisory.

The merits of setting standard terms and definitions

Questions For Discussion

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

We believe standardisation of terms and definitions of MySuper group life policies will not dramatically simplify this area of the super system. As detailed above the wording of a contract is only one component of the provision of insurance benefits within super funds.

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?

No comment.

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

The current definition of 'permanent incapacity' as contained in the SIS Regs remains an appropriate definition.

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

By definition, TPD means it is "unlikely" you will return to work due to mental or physical illness. That is, your level of disability should be quite high with the result that returning to work is unlikely. We accept that in some cases it can be quite difficult to determine the future employability of a person at a point in time. This does not mean that some actions to improve the person's quality of life via rehabilitation should not be possible. But if it is felt that return to work initiatives would be suitable for a particular case then it is likely the person may not have been permanently incapacitated but potentially temporarily incapacitated. On this basis return to work initiatives should be encouraged in the temporary incapacity benefit area.

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?

No comment.

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

The design of these benefits is a fundamental aspect of the operation of a super fund and any

© Chartered Accountants Australia and New Zealand ABN 50 084 642 571 (CA ANZ). Formed in Australia. Members of CA ANZ are not liable for the debts and liabilities of CA ANZ.

adjustments need to be done with a great deal of care. Consequently we believe a long lead time would be required.

Impact on premiums

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

This would depend on the standardized words that were to be mandated and what additional work that would be required by life offices to implement proposed changes.

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

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

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

No comment on any of these above questions.

Improving consumers' understanding of insurance in superannuation

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 noted above we believe the terms, definitions and exclusions are just one part of a complex jig-saw involving superannuation and life insurance policies. Given most consumers regrettably take little or no notice of their superannuation investments we do not believe common insurance benefits would significantly aid understanding.

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

In previous submissions we have argued that government and the superannuation industry need to work with internationally recognized behavioural scientists to fully understand why consumers are not particularly interested in what happens with almost 10% of the remuneration and what could be done to turn this unfortunate situation around.

Merits of prescribing minimum, maximum or set levels of cover

© Chartered Accountants Australia and New Zealand ABN 50 084 642 571 (CA ANZ). Formed in Australia. Members of CA ANZ are not liable for the debts and liabilities of CA ANZ.

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?

We do not agree with set levels of insurance cover in the superannuation space.

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?

In our view uniformity does not necessarily create a better result.

***

Should you wish to discuss the contents of this submission, please contact me on +612 8078 5404 or tony.negline@charteredaccountantsanz.com.

Yours faithfully,

Tony Negline CA
Senior Consultant - Superannuation and Retirement Incomes
Advocacy, Professional Standing and International

© Chartered Accountants Australia and New Zealand ABN 50 084 642 571 (CA ANZ). Formed in Australia. Members of CA ANZ are not liable for the debts and liabilities of CA ANZ.

Appendix A

Chartered Accountants Australia and New Zealand

CA ANZ is made up of over 120,000 diverse, talented and financially astute professionals who utilise their skills every day to make a difference for businesses the world over.
Members of CA ANZ are known for professional integrity, principled judgment and financial discipline, and a forward-looking approach to business.

We focus on the education and lifelong learning of members and engage in advocacy and thought leadership in areas that impact the economy and domestic and international capital markets.

We are represented on the Board of the International Federation of Accountants and are connected globally through the 800,000-strong Global Accounting Alliance, and Chartered Accountants Worldwide, which brings together leading Institutes in Australia, England and Wales, Ireland, New Zealand, Scotland and South Africa to support and promote over 320,000 Chartered Accountants in more than 180 countries.

© Chartered Accountants Australia and New Zealand ABN 50 084 642 571 (CA ANZ). Formed in Australia. Members of CA ANZ are not liable for the debts and liabilities of CA ANZ.

Appendix B

Typical super fund death benefit payment process involving insurance claim*

Administrator (often beneficiary's main contact point)	Trustee*	Insurer	Step
Informed of death			1
Provides initial information to trustee and insurer if benefit insured	Examines information and makes initial request for further information about beneficiaries	Examines supplied information and (if relevant) medical history including disclosed pre-existing conditions. Makes initial request for further information about deceased and seeks medical evidence	2
Requests further information as requested by trustee and insurer from beneficiaries and potentially legal representatives		May request probate so that medical evidence can be obtained (signatures of LPR will be required to be verified)	3
Once information supplied, forwards to trustee and insurer	Examines information. Makes determination on beneficiaries, if possible. If necessary requests additional information	Examines medical information. Makes determination, if possible. If necessary requests additional information	4
Gathers additional information if requested by trustee and/or insurer	Assesses information and may request further information		5
Forwards additional information to trustee and insurer	Trustee (SCT?) makes final determination re whom benefit will be paid to, in what proportion and how it will be paid	Takes final decision on payout of benefit. Release form sent to trustee (via administrator) to be signed	6
Administrator informed of trustee and life insurer's decisions	Trustee informed of decision and signs release form. If payment to be made will demand release form be signed by beneficiary		7
Administrator tells beneficiaries of trustee and (if relevant) insurer decisions	Release form supplied to insurer	Lump sum paid to trustee	8
Administrator requisitions payment (less applicable tax) to be paid to beneficiaries	Approves requisition and returns to administrator – commonly requires tabling at trustee meeting		9

Administrator (often beneficiary's main contact point)	Trustee*	Insurer	Step
Administrator draws cheque for payment or arranges direct credit (less applicable tax) to be paid to beneficiaries	Signs cheque(s)		10
*May also be administrator if a life company, ie, “public offer” fund			

* Source – Negline, T. *The Essential SMSF Guide 2018/19*, Thomson Reuters, p. 476

© Chartered Accountants Australia and New Zealand ABN 50 084 642 571 (CA ANZ). Formed in Australia. Members of CA ANZ are not liable for the debts and liabilities of CA ANZ.