



FINANCIAL
SERVICES
COUNCIL

Universal terms for insurance within MySuper – Issues Paper

FSC Submission

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1. About the Financial Services Council

The FSC is a leading peak body which sets mandatory Standards and develops policy for more than 100 member companies in Australia's largest industry sector, financial services.

Our Full Members represent Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks and licensed trustee companies. Our Supporting Members represent the professional services firms such as ICT, consulting, accounting, legal, recruitment, actuarial and research houses.

The financial services industry is responsible for investing almost \$3 trillion on behalf of more than 14.8 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange, and is the fourth largest pool of managed funds in the world.

2. Introduction

The insurance cover provided for MySuper members under the *Superannuation Industry (Supervision) Act 1993* (SIS Act) provides an important safety net for many Australians, with over 70% of life insurance policies held through superannuation, and over 80% of premiums collected paid back to members.¹

Superannuation trustees have an important role in ensuring their members have appropriate levels of cover that suit their circumstances, as required by section 52(7) of the SIS Act.

However, as noted in the Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (the Final Report), consumers often struggle to understand and compare insurance policies.²

Understanding cover is particularly important at claims time to help ensure members understand the process and their expectations align with outcomes.

Comparing cover may be important for an individual who is changing jobs and deciding whether to keep their existing default fund and insurance arrangements, move to the default fund of their new employer, or make other arrangements.

The FSC and our member organisations are committed to making it easier for consumers to understand and compare life insurance cover arrangements, both inside and outside superannuation. We look forward to ongoing engagement with Government and industry on this important issue.

2.1. Potential scope for standardisation

There are a range of potential approaches that could be taken to standardisation of terms and definitions within MySuper, several of which are mentioned in the Issues Paper.

As a guiding principle, the FSC supports standardisation to the extent that it does not lead to detrimental member outcomes.

In the first instance, **the FSC is supportive of further work to determine where terminology and descriptions can be usefully standardised.** This should be the primary initial focus for a standardisation initiative, and can be most effectively led by industry.

Part of this work would involve creating a common approach to labelling and descriptions to improve consumer understanding of policies, for example creating standard language for commonly used terms including:

- income protection/salary continuance
- active employment/at work

¹ APRA Quarterly Life Insurance Statistics Dec 2018, released Feb 2019

² Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, *Final Report Volume 1* (2019), p 322

Consumer testing and collaboration across the industry will be necessary in order for this work to be successful. Industry is well-placed to lead such an initiative.

Through the Insurance in Superannuation Working Group (ISWG), further industry standardisation work is also being explored, which would need to be implemented over a longer time period. This includes:

- a statement of purpose for total and permanent disablement (TPD) cover, including consideration of whether the title of this type of cover accurately reflects its purpose;
- standardising elements that make up TPD and terminal illness cover to create 'building blocks' for trustees to better design cover to meet members' needs;
- removal of opinion clauses where possible and appropriate, to enable objective assessments; and
- standardising evidence considered in assessment, up to the point where the claim is assessed.

Further work would need to be undertaken to determine the costs and benefits to consumers of more significant standardisation projects, including standardising exclusions or introducing minimum, maximum or set levels of cover, to avoid consumer detriment.

Such projects would need to be undertaken over a longer time period taking into account other industry developments such as the implementation of the Insurance in Super ISWG Code of Practice (the ISWG Code).

2.2. Existing industry initiatives

The FSC is an ongoing participant in ISWG and supports the ISWG Code. While this does not apply to all trustees, the vast majority of MySuper members are members of funds which have signed up to the ISWG Code.

The ISWG Code includes a range of measures which will help to improve consumer understanding of insurance within superannuation and minimise inappropriate account erosion.

For example, the ISWG Code sets an expectation that premiums should not exceed 1% of an individual's expected lifetime salary. This effectively caps premiums, and therefore levels of cover.

In addition to the Code, a Key Fact Sheet (KFS) was created as a tool to help improve comparability of insurance in superannuation. This document underwent consumer testing as part of development process.

The next edition of the Life Insurance Code of Practice will also be extended to bind trustees who are members of the FSC. The requirements for trustees will closely align with the ISWG Code.

This will help to ensure that consumers receive consistent levels of service whether their insurance is held inside or outside superannuation. As noted above, the FSC has been

working with the ISWG to progress industry conversations about potential for greater standardisation, including standardising labelling and description of common terms.

The FSC notes that the ISWG has also made a submission in response to the Issues Paper, which we support.

2.3. Impact of standardisation on State insurance duties

It will also be important to consider potential implications for insurance duties because of any policy changes relating to standardisation.

For group insurance arrangements, the contract of insurance is the issue of a group insurance policy between the insurer and the trustee of the superannuation fund. While the member joins the superannuation fund and is covered by that group policy, there is not contract between insurer and insured member. This adds a level of complexity to stamp duty arrangements.

Insurers must also take into account the rates, bases and definitions of eight State and Territory legislations. In some cases, revenue offices consider a new contract of insurance is deemed to have issued or occurred even though at law, there may not have been any actual or significant change to the existing contract.

Scenarios which may trigger unintended duty consequences include:

- imposition of minimum cover requirements in excess of current sum insured under a particular policy;
- creation of a mandated maximum which exceeds the current maximum coverage under a policy, where this is considered a new benefit by States.

The FSC considers any change to life insurance as a result of this process, such as the requirement to increase levels of cover, should not result in extra insurance duty being imposed by State Governments (this issue relates to life insurance duty as well as general insurance duty, as life insurance can be subject to general insurance duty in some States).

If a change in life insurance terms did result in increased State stamp duty, this cost would flow through to premiums without creating any consumer benefit.

Therefore, the FSC urges the Federal Government to design any change to minimise the potential for any increase in duty and liaise with relevant Offices of State Revenue to ensure no increase in State insurance duty will occur in practice.

3. Response to consultation questions

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

There are a range of potential benefits from undertaking different standardisation work.

At a high level, standardisation generally has two main objectives:

1. Making policies easier for consumers to understand and compare (for example, through standardising terminology)
2. Ensuring MySuper members have an appropriate level of cover that balances suitability and affordability (for example, through standardising inclusions/exclusions and setting minimum/maximum levels of cover)

The FSC believes the first of these is significantly more achievable in the short to medium term.

More specific, consumer benefits of standardisation may include:

- Increasing community understanding of life insurance products and terminology over time through standardisation and simplification of language (similar to the way many general insurance terms such as “excess” are readily understood);
- Reducing the potential for a gap between member expectations and outcomes in the event of a claim;
- Simplifying member transfers to a new fund;
- Reducing uncertainty in how terms and definitions will be interpreted in the event of a complaint to AFCA or where a matter progresses to the legal system;

The costs of standardisation would depend on the nature of changes undertaken. They could include:

- Increased premiums for some or all individuals, particularly where standardised terms will result in broader cover than those based on terms and definitions currently in use;
- Reduced discretion for trustees to choose cover appropriate to their members, and potentially reduced levels of cover for some members raising potential concerns for compliance with the requirements under section 52(7) of the SIS Act;
- Reduced competition if trustees cannot compete based on the cover they offer to members;
- Payment of state insurance duties on policies where cover is required to be increased;
- Mispricing, particularly where new definitions have no historical claims experience or are introduced too quickly to effectively price;
- Increased consumer confusion where cover and/or pricing is changed;
- Legal risks, and potential pricing implications, where interpretations by AFCA or the courts differ from those intended by industry;

- Uneven impacts across different member cohorts (for example, high risk member pools are more price-sensitive to change than others);
- Impediments to innovation by trustees and insurers in the development of new products, terms and definitions to cater to specific needs of a particular member pool.

Under some scenarios, the above costs could be significant. It will be important for any project aiming to standardise elements of group insurance to carefully balance the costs and benefits for consumers. There is potential for changes to dramatically increase premiums for some fund members. Some cohorts could also become uninsurable (for example, heavy manual occupations or contract employees) because they have been included in risk pools based on particular definitions and may not be able to be insured under a different 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?

It will be important to understand where the biggest opportunities exist for improving consumer outcomes through standardisation, in order to effectively prioritise this work.

Ideally, this work should involve government and industry collaboration with regulators, external dispute resolution bodies and consumer advocates to determine:

- Where labels/terminology are already used almost consistently in the same context in different policies (for example 'medical practitioner', 'pre-existing conditions', terminal illness');
- Where different labels/terminology are used to mean the same thing in different policies (for example 'at work' and 'active employment');
- Where policies use the same labels/terminology with different meanings (for example, 'TPD', 'activities of daily living');
- Where exclusions for benefit payments are already fairly standard, due to underpinning policy considerations (for example, suicide and self-harm, pandemic and war exclusions);
- What terms/terminology create the most confusion of consumers (for example, 'unlikely' and 'unable', 'TPD').

The costs and benefits of standardising inconsistent labels and terms and the ease of standardising them should then be considered to prioritise future work. Consumer testing will also be vital throughout any standardisation process, and should be used to assess outcomes.

The FSC is committed to working with industry through the ISWG to drive this work.

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 definition of ‘permanent incapacity’ in the SIS Act is not an insurance definition.

This wording is intended to set the parameters for early release of superannuation funds by trustees. This needs to be applicable to all members, including those without insurance cover.

If ‘permanent incapacity’ in the SIS Act was applied as a TPD definition in policies, it would result in cover that is significantly broader than what is provided to members on average today. This may be suitable for some member pools, but for some high-risk pools it could excessively increase premiums.

However, if the SIS Act definition is recalibrated to align with typical TPD definitions, this narrow definition may result in individuals not having access to funds, either from an insurance claim or through other early release mechanisms. This would not be a desirable outcome.

Confining trustees to a single definition may also remove discretion of a trustee to vary the definitions applied, for example to set a higher threshold where it is in the interest of their members to do so.

Whatever the SIS Act definition, insurance policy definitions should not be required to use the same wording as that definition, as long as they still satisfy the condition of release.

However, the SIS Act definition may need to be reviewed as part of any industry standardisation process, to ensure consistency with changes made or to align terminology.

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

Yes, the definition of TPD should allow insurers to offer rehabilitation and/or return to work initiatives, to the extent they promote members returning to health and improve the overall sustainability of group TPD insurance.

Reasonable potential for rehabilitation should be taken into account in TPD definitions alongside members’ education, training and experience as it encourages a positive mindset for members and encourages their participation in vocational rehabilitation where possible. We already know that many TPD claimants later return to work – one study showed that 36% of individuals who had a TPD claim paid had returned to work or were actively seeking work.³

³ <https://www.sunsuper.com.au/library/media/sunsupermedia/documents/pdfs/media-releases/sunsuper-launches-industry-leading-tpd-insurance-product.pdf>

Rehabilitation and return to work initiatives in TPD definitions can improve outcomes for individual members, as well as lowering the incidence of TPD claims and improving the long-term sustainability of group TPD insurance.

Some insurers already offer rehabilitation as part of income protection policies. However, not all insurers offer this and many trustees are unable to offer income protection as a default benefit to their members due to cost, in particular to remain under the 1% cap in the ISWG Code. Numerous research reports show returning to work can play a hugely important role in a person's recovery.

Analysis undertaken by the Australian Faculty of Occupational and Environmental Medicine in 2011 showed if a person is off work for 20 days, the likelihood of them returning to work is 70 per cent. If they are off work for 70 days, this likelihood falls to 35 per cent. SunSuper research showed that 69% of members who had been paid a TPD claim wanted assistance with rehabilitation/retraining, and 66% wanted help finding work.⁴

Research undertaken for the FSC by Cadence Economics shows that early intervention by insurers could prevent up to 87 Australians per year from becoming totally and permanently disabled.

Rehabilitation also aligns with the trustees' sole purpose test, as members who return to work will be able to continue contributions in their super accounts and augment their retirement funds.

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?

Very few exclusions generally apply to default cover in group insurance arrangements.

The 'general' exclusions that exist are intended to improve the sustainability of group insurance arrangements or curb anti selective behaviours, and should be examined for possible standardisation at an appropriate time.

However, given these exclusions define the level of risk and therefore the pricing of these policies, any work to standardise exclusions would need to carefully consider pricing implications, as this would directly impact affordability and levels of cover.

However, we would support assessing the costs and benefits of standardisation per Questions 1 and 2 above, particularly relating to standardisation of labelling/terminology.

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

⁴ <https://www.sunsuper.com.au/library/media/sunsupermedia/documents/pdfs/media-releases/sunsuper-launches-industry-leading-tpd-insurance-product.pdf>

Any changes to terms, definitions or exclusions in group insurance policies would require changes to trustees' arrangements with their insurers. Grandfathering arrangements may also need to be considered if current policies are more favourable than standardised policies.

In order to minimise costs and ensure accurate pricing, changes to terms should be implemented with sufficient transition time to be built into insurance renewal cycles. This may require a 2-3 year transition window.

Reducing the implementation period would increase the cost of making the changes in the first instance as it would require out-of-cycle changes to policies, but also risk additional premium impacts if insurers are not able to appropriately price for the changes upfront. In addition, it would make it more difficult to appropriately train staff and educate consumers about changes to their policy.

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 clear idea of the terms, definitions and/or exclusions to be standardised, and the manner in which they are to be standardised.

In general, the greater the scope and scale of changes to policies, the greater the impact on premiums.

Generally speaking, premiums are likely to increase if definitions are broadened (due to additional claims paid) or made more complex to assess (due to additional resources and information required to assess claims).

Premiums may decrease if cover is effectively reduced or capped, where trustees currently offer more generous cover.

It is also important to note that group policies are priced based on the characteristics and level of risk in the pool – this will mean that standardising terms will not necessarily standardise pricing between different funds with different membership profiles. For example, a standardised definition may result in a greater premium change in a pool characterised by members in high-risk occupations than it would in a pool characterised by members with low-risk occupations.

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

Without knowing what changes were to be implemented, it is not possible to assess whether pricing impacts would outweigh the benefits. As noted above, close consideration of the costs and benefits of any standardisation activity should be undertaken before implementation.

The premium impact is also unlikely to be consistent, as it will depend on how different new definitions are from those already in place for specific funds.

It is also important to consider the 1% cap in the ISWG Code, and whether standardisation leading to pricing changes which would exceed this cap are in the best interests of members.

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

Retaining trustee discretion to design insurance cover appropriate to their membership base would help to ensure that cover continue to be carefully designed with regard to both cost and suitability.

Trustees must retain the levers available to adjust policies to comply with their SIS Act obligations to provide appropriate benefits.

The 1% cap in the ISWG Code already reduces the ability to increase premiums to offer preferred cover. The two other main levers at the disposal of trustees are policy terms and cover levels.

Currently, trustees can mitigate costs by adjusting definitions to make it affordable to provide some cover for a particular event, rather than none at all. However, if policy terms are standardised, changing the level of cover is the only remaining option for trustees to manage premiums and the level of cover for many members is likely to be reduced.

Reduction or elimination of State Government stamp duty, which can account for 5-10% of insurance premiums, could aid in mitigating pricing impacts.

As noted above in Question 6, applying changes with an appropriate lead time should also prevent unnecessary pricing impacts.

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

See Question 6 above.

Repricing of premiums will flow through to members as soon as standardised terms/definitions are implemented in their policy. Accordingly, pricing impacts are likely to be more easily managed where there is a suitable transition period.

However, the full impact on pricing may take several years to determine, as claims experience is established.

Price impacts depend on a range of factors, including:

- the type of cover (for example, death claims are usually notified earlier than TPD claims, meaning pricing changes flow through more quickly)
- the risk profile of the member pool (higher risk pools are more price sensitive)
- the degree of variance between the current definition and the standardised definition.

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 above, the FSC believes that improving the consistency of labelling/terminology would help to improve understanding of insurance in superannuation and facilitate comparisons.

However, specific standardised terminology could still be problematic for members. Effective consumer testing and accessible education materials will assist in managing consumer outcomes.

Further work is required to understand the extent of consumer benefits flowing from different approaches to standardisation, and how these balance with potential costs.

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

Effective member engagement by funds and insurers is an important factor in improving understanding of insurance in superannuation. Measures in the ISWG Code, such as requirements to communicate in a clear and timely fashion using plain language will also assist in improving consumer understanding when they interact with their fund in relation to their insurance cover.

Similarly, increased adoption of consumer testing has helped improve the design of products and documentation to enhance understanding. Better documentation, such as the use of Key Fact Sheets as developed by ISWG, is also helpful.

Measures to reduce the number of duplicate superannuation accounts (and therefore insurance policies), such as a 'default once' model, may also make it simpler for members to engage with their superannuation and their insurance cover.

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?

There should not be a need for levels of cover to be further prescribed within MySuper.

Trustees are already 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 and premium costs.

The requirement for trustees to make decisions that are in their members best interest, in addition to boundaries set by the ISWG Code such as the 1% cap, should ensure that appropriate cover is provided without the need to further prescribe levels of cover.

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

Any move to further prescribe levels of cover should take into account:

- The best interests of members of superannuation funds
- existing measures in place to ensure appropriate levels of cover (see Question 13);
- the anticipated premium impact across all members, particularly if the goal of prescribing cover is to reduce balance erosion;
- the anticipated impact on levels of cover and claims outcomes.

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

The consequences of setting particular levels of cover are difficult to understand without a concrete proposal to comment on. However, in general:

- Mandating further minimum levels of cover could make premiums unaffordable for some individuals/cohorts.
- Mandating further maximum levels, particularly if set too low, could remove the discretion of trustees to provide additional protection for particular cohorts of members where the trustee has formed the view that this is in their members' best interests, and (depending on the model chosen) could impact the ability of individuals with specific risks (such as those in high risk occupations) to obtain additional cover.
- Setting cover at a specific level would remove the ability of trustees to make informed decisions about the appropriate level of cover for their membership (for example, a trustee may determine that more IP cover is better for their members rather than TPD, but be prevented by standard cover requirements).