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Division Head
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Universal terms for insurance within MySuper

Dear Sir/Madam

Industry Super Australia (ISA) is a strong supporter of the distribution of group insurance on an opt-out basis to most members of MySuper products that is appropriate to the membership of each superannuation fund and consistent with maximising retirement benefits to members.

Group insurance within superannuation is a cost effective means by which members of superannuation funds can obtain insurance cover to assist members and beneficiaries cope with the costs associated with death, disability and long-term illness. Most life – and a significant percentage of disability insurance in Australia – is provided via group insurance within superannuation.

We welcome the opportunity to comment on some of the issues raised by the "Universal terms for insurance within MySuper Issues Paper" ("the Issues Paper").

Many of the questions raised in the Issues Paper will only be capable of being answered for policy purposes following further detailed consultation with the superannuation industry. We therefore limit this submission to commenting on a number of high-level matters raised by the paper.

Key Points

This submission includes the following key points:

- ISA agrees there is merit in giving further consideration to standardising the meaning of key terms that comprise types of life insurance distributed via superannuation.

- ISA does not support mandating the definition of insurance types, such as TPD. Trustees must retain the ability to design types and levels of insurance appropriate to the demographic of their fund.

- Any further consideration of the standardisation of key terms by the government must involve close ongoing consultation with the industry.

- All group insurance distributed via superannuation – not only that attached to MySuper products – should be subject to the same standardised definitions of key terms that may be introduced.

- Standardisation of key terms will not by itself solve the problem that some members have inappropriate insurance. This will require more pro-active enforcement by APRA, and a strengthened industrial safety net under the remit of the Fair Work Commission that ensures members are always in good quality MySuper products with insurance appropriate to their industry.

We discuss these points in more detail below.

The Royal Commission

The Issues Paper is a response to the Final Report of the Royal Commission into misconduct into the financial services industry. In his report Commissioner Hayne noted that insurance contracts can be difficult for most consumers to understand, and that subtle differences in definitions, terms and exclusions between policies can make effective comparisons difficult to undertake.[1]

Most members of superannuation funds are members of MySuper products. Section 68AA of the Superannuation Industry (Supervision) Act 1993 requires each trustee to provide most MySuper members with permanent incapacity and death benefits on an opt-out basis.

Commissioner Hayne therefore recommended that "Treasury, in consultation with industry, should determine the practicability, and likely pricing effects, of legislating universal key definitions, terms and exclusions for default MySuper group life policies" (Recommendation 4.3).

The Commissioner added that any moves toward such legislation must first identify the pricing implications of standardisation:

> "Changes will almost certainly affect the cost of insurance premiums, and will affect how much superannuation the member will have at retirement. Hence,

[1] Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Volume 1, p. 322

> the adoption of standardised terms should be carefully considered, and the consequences of change identified, before they are implemented."[2]

Following on from the Commissioner's Final Report, the headline question posed by Treasury's Issue Paper is whether there is merit in pursuing the standardisation of key terms, definitions and exclusions for default insurance cover provided for all MySuper products.

Support for Targeted Standardisation of Key Terms

ISA supports giving further consideration to legislating key terms in group insurance distributed via superannuation. However, close consultation with the industry, combined with appropriate safeguards so that members do not find themselves with junk policies, will be crucial for the success of any standardisation project.

In supporting the principle of standardisation, ISA supports the current regulatory regime that obliges superannuation trustees to offer suitable types and levels of insurance, which suit the demographic composition of their members.[3] Trustees should continue to have the flexibility to offer insurance that is designed to meet the interests of their membership.

Any moves toward the standardisation of terms must be considered in the context of the interplay of the three key factors impacting on insurance: (i) risk, (ii) terms and (iii) the cost/level of cover. Standardised terms should not negatively impact on the level and cost of cover to members or unduly restrict the ability of individual trustees to offer appropriate types and levels of insurance to suit the demographic of their fund.

There is scope for targeted standardisation to the benefit of members. For example, in the context of defining a claimant as being "unable" to work again there can be significant variation across policies in relation to qualification periods, types of work against which the ability to return to work or eligibility for a Total and Permanent Disability (TPD) is assessed, and requirements to undertake rehabilitation treatments. A consequence is that policies that appear to offer a similar type of TPD cover based on being "unable" to work can generate very different outcomes for claimants with similar risk and disability profiles.

At a system level these variations in definitions may help to explain why, among the main categories of insurance, TPD has the highest rate of declined applications and the lowest rate of claims accepted in full. In addition, the rate of declined claims varies

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[2] Final Report of the Royal Commission, p. 323

[3] The regulatory regime is centred on the obligations found in the Superannuation Industry (Supervision) Act 1993, prudential standards that include SPS 250 Insurance in Superannuation, and the Insurance Contracts Act 1984

widely across insurers, from 7 per cent to 37 per cent – strongly suggesting that some claims are being denied on the basis of excessively restrictive definitions.[4]

There is also a significant variance in the ratio of premiums paid to payments made in different sections of the industry. Insurers for not-for-profit superannuation funds pay in excess of 80 per cent of premiums back to members, while insurers for the for-profit retail sector pay significantly less at approximately 50 per cent.[5]

While ISA supports giving consideration to standardising key terms, we do not support requiring trustees to use certain key terms, such as “unable” or “unlikely” to work in the context of TPD. The Issues Paper notes the regulatory framework that trustees operate within when deciding the design and pricing of cover. This includes Section 52 of the SIS Act which, among other things, requires trustees to offer insurance with “regard to the demographic composition of the beneficiaries of the entity” and which “does not inappropriately erode the retirement income of beneficiaries.”

Providing cover that is appropriate to the age and occupational profile of each superannuation fund, at a price negotiated with different insurers that does not unduly erode balances, cannot be secured simply by mandating complete definitions of what TPD and income protection must include. Legislating relatively “loose” definitions risks increasing premiums and a reluctance by insurers to offer cover for some cohorts of high risk members. Tightening definitions in law risks cultivating an insurance safety-net that provides support to members only in the most extreme circumstances.

Striking a balance between these objectives in the interests of members is best achieved by trustees, in a context where trustees are subject to effective oversight and must be able to establish the value of their insurance offering to secure default superannuation contributions. We discuss what this means for policy in more detail below.

<u>The Limits to Standardisation in MySuper</u>

While a degree of standardisation has the potential to benefit members, it will not by itself solve the problem of how to ensure members are connected to good value, industrially-relevant insurance.

Commissioner Hayne’s recommendation to consider standardising terms in MySuper insurance flows from a broader concern that some members are not obtaining access to the cover they will need if they find themselves in circumstances where they need to

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4 ASIC (2016) Life insurance claims: An industry review, Report 498

5 See APRA (2017) Quarterly Life Insurance Performance Database to December 2016, and KPMG (2017) Review of Default Group Insurance in Superannuation, p. 5, available at https://assets.kpmg/content/dam/kpmg/au/pdf/2017/default-group-insurance-superannuation-review.pdf

make a claim. In tackling this problem the Commissioner's focus is on using standardisation to enable MySuper members to make better choices.

This focus on engaging and informing members as the basis for improving their default insurance is misplaced. While trustees should make efforts to better inform members, the evidence is that for a range of behavioural and cognitive reasons the large majority of superannuation fund members do not understand superannuation, they do not engage with the detail of their account – and when some do make choices they often suffer financial harm.[6]

This pattern of disengagement and poor choices helps to explain why the recently completed Productivity Commission inquiry into the superannuation system found that several million members are in MySuper, choice and SMSF products that persistently underperform.[7] If simplified forms of information were an effective solution to this problem, then the introduction of MySuper dashboards in 2013 should have made significant inroads into solving it. However, millions remain in poor performing MySuper products, indicating that there is no information-fix to disengagement. We therefore agreed with the Productivity Commission when it concluded:

> "Given generally low levels of financial literacy among members, understanding and comparing insurance offerings will always be difficult given the different mixes of insurance types and levels of cover"[8]

However, the widespread and persistent nature of membership disengagement from superannuation and related insurance provision raises several important issues.

Firstly, it is not clear why the potential legislative standardisation of key terms in areas such as TPD should only be applied to policies attached to MySuper products.

The evidence is that many members of choice products are as likely to make poor decisions as those in MySuper products. In a compulsory superannuation system designed to deliver collective social policy outcomes, and in which poor financial literacy and poor choices are endemic across the default and choice segments, all members deserve the same levels of protection from being sold into inappropriate insurance.

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[6] We discuss the sources and consequences of low engagement and financial self-harm in more detail in our response to the Productivity Commission's draft inquiry report on the efficiency and competitiveness of the superannuation system. See: ISA (2018) Disconnect: the PC's findings do not support its recommendations, at https://www.pc.gov.au/__data/assets/pdf_file/0016/230146/subdr162-superannuation-assessment.pdf

[7] See chapter 2 in the Productivity Commission's final inquiry report.

[8] Productivity Commission (2018) Superannuation: Assessing Efficiency and Competiveness, Inquiry Report, p. 408

It follows that all group insurance distributed via superannuation should be subject to the same standardised definitions of key terms that may be introduced.

Secondly, if member behaviours in response to standardised terms cannot be relied upon to improve the quality of insurance cover they obtain via superannuation, there must other policy mechanisms to protect their interests. This should mean an enhanced focus on member interests by APRA and a strengthened industrial safety net for default members.

APRA is responsible for developing and enforcing a robust prudential framework that promotes prudent behaviour by superannuation funds with the aim of protecting the interests of members. To this end APRA has developed Prudential Standard SPS 250 Insurance in Superannuation which includes the expectation that trustees offer and manage any insurance cover by reference to "the collective best interests of beneficiaries of the RSE as a whole."[9]

However, it is unclear how and to what extent APRA has pro-actively policed and enforced this expectation. To what extent does APRA challenge funds in relation to the conflicts of interest that can arise when retail RSEs purchase insurance from entities that are part of the same corporate group? Do the claims histories of particular RSEs in areas such as TPD suggest that policies are operating in the best interests of beneficiaries? In short, while APRA has made clear what it expects from RSEs, does it routinely challenge funds to prove that those expectations are being met?

At a general level the Productivity Commission expressed concern that APRA's focus to date has tended to be on funds as managers of risk to themselves rather than on whether the interests of fund members are being protected or harmed.[10] Similar concerns were expressed by the Royal Commission.[11]

The capabilities and culture of APRA are currently under review. ISA has contributed to that review, arguing that APRA must be resourced and motivated to routinely challenge funds about the quality of the services and products they provide to members. Group insurance is one such product. While the capability review is formally separate from the focus of the Issues Paper, its conclusions will likely have significant implications for tackling some of the problems that standardising key insurance terms are intended to address.

A further means of helping to ensure members are connected to appropriate insurance arrangements is via the industrial default fund safety net. A version of this safety net operated until 2014, after which it has been effectively suspended because the government has not made appropriate appointments to the superannuation expert panel.

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[9] APRA SPS 250 Prudential Practice Guide, p. 7
[10] Productivity Commission (2018) p. 43
[11] Royal Commission (2019) p. 452

ISA supports re-starting the suspended process, but in a strengthened form. Funds would apply to the Fair Work Commission to be named in a modern award. One of the criteria they would be assessed against is the appropriateness of their insurance offering to the employees covered by the award. This would include consideration of the risk profile of particular industries and occupations, and if the default group insurance attached to the MySuper product was therefore suitable. As members move between industries their balance would be automatically transferred into a good quality MySuper product that provides insurance appropriate to the new industry.[12]

The significance of an effective industrial safety net for default members is that it does not rely on unreliable member engagement and understanding to improve outcomes in insurance: members are connected to appropriate insurance without having to act and without having to make choices that are likely to result in financial self-harm.

Finally, we make the point that most superannuation trustees purchase insurance from external commercial providers on behalf of their members. There are a limited number of providers of group insurance, and funds have to manage a number of trade-offs and factors when negotiating and reaching agreement. Any moves toward standardisation must ensure that the ability of trustees to obtain appropriate and cost effective insurance that is in the best interests of their particular groups of members is not diminished.

We appreciate the opportunity to comment on the Issues Paper. Please do not hesitate to contact us with any questions.

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[12] We discuss aspects of the strengthened default safety net in more detail in our response to the Productivity Commission's draft superannuation report: ISA (2018) Disconnect.