



Universal terms for insurance within MySuper

MLC Life Insurance submission to Treasury issues paper

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Contact:

James Connors

Senior Consultant, Government and Policy

MLC Life Insurance

☎ 0484 083 208

✉ James.connors@mlcinsurance.com.au

Key point summary

- Standardising life insurance in superannuation terms and definitions is worthy of consideration, but would require careful implementation. Policy makers should strive to find a balance between standardisation of terms and definitions on one hand, and preservation of trustee flexibility on the other.
- Properly implemented, standardising terms and definitions should increase the ability of customers to understand and compare insurance coverage. However, where the standardised terms and definitions lead to an increase in claims cost for a product, then standardisation will come at a financial cost to people with that product.
- Prescribing realistic minimum standard levels of TPD and death cover is a sound approach to standardisation, as this will prevent the creation of junk insurance while permitting trustees the flexibility to adopt a higher standard where appropriate. Neither set nor maximum levels of cover should be prescribed.
- Bearing in mind other life insurance in superannuation changes that have been legislated or are proposed, policy makers should allow sufficient implementation time for trustees and insurers to understand the insurance and pricing impacts, so as to minimise negative consequences on consumers.
- Where possible, policy makers should seek to adopt a bundling approach to policy change that allows entities to properly coordinate the resulting system changes. Doing so will help to minimise the costs and risks for trustees and insurers, and ultimately for consumers.

Opening comments

MLC Life Insurance welcomes the opportunity to provide a submission to the Treasury issues paper concerning Universal terms for insurance within MySuper. We understand the issues paper is to form part of the Australian Government's commitment to take action on recommendation 4.13 of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry.

Default life insurance in superannuation is a key feature of the Australian superannuation system, bringing affordable life insurance coverage to millions of Australian's and their families. For many superannuation customers the insurance cover provided by their superannuation fund is the only life insurance they hold. Without this cover, in the event of death or a serious, injury or illness, a person is left to rely on their own (often limited) resources, or those of the broader community. For this reason changes to life insurance in superannuation should always be carefully considered.

The experience of life insurance in superannuation customers is shaped by the contractual terms of their policy and employer and employee needs, the trustee's insurance management framework, the relevant fund's Trust Deed and the insurance contract. Unlike retail life insurance, the terms of a life insurance in superannuation policy is not responsive to individual circumstances; rather it is designed to meet the needs of the super fund's membership as a whole and, in group arrangements, the employer's obligations and need to provide insurance for its employees. The policy is owned by the trustee of the customer's superannuation fund, who is responsible for determining terms with the insurer, based on their shared understanding of the characteristics of the insured population, and allowing for sufficient flexibility in terms to meet the demographics applicable to the employer and employees.

Given the default, opt-out nature of insurance in superannuation it is important customers can rely on insurance in superannuation providing certainty of cover and good value for money. As noted by Commissioner Hayne in his findings leading to recommendation 4.13, insurance in superannuation can be

difficult for consumers to understand, which undermines both certainty and value. This led the Commissioner to conclude that one way to address consumer understanding is by greater levels of standardisation in insurance in superannuation product design, including greater standardisation of key definitions, terms and exclusions.

We agree it is desirable for consumers to have a greater understanding of their insurance in superannuation cover. Furthermore we agree standardisation of terms and conditions is one way to do this. We consider however that any proposal to standardise terms and conditions needs to be alert to:

- possible side effects that could lessen value and certainty for some customers
- that the absence of a greater degree of industry standardisation is only partially responsible for consumer confusion
- that the issue best addressed by combination of standardisation and other measures. We address these issues in our responses to the issues paper discussion questions, below.

Whatever the final shape of the reforms that are made to address recommendation 4.13, we urge policy makers to be cognisant of recent and mooted future changes to the structure of insurance in superannuation. The effect of these changes, in particular the impact of *Protecting Your Super* on participation rates, premiums for remaining members and industry sustainability, are yet to emerge. Super funds, life insurers, and consumers need sufficient time to absorb these recent changes. There is a danger that constant change may be counter-productive and could result in even lower engagement in insurance than the industry is experiencing at present.

We also note that implementing system changes is not without cost or risk. While neither cost nor risk should on their own determine policy, the impact of multiple policy driven system changes on entities and customers should be taken into account by policy makers. Where possible, policy makers should seek to coordinate policy reforms so as to enable entities to bundle the resulting system changes. Doing so will help to minimise the additional cost and risk that comes with re-scoping in flight projects or performing re-work.

Our final opening comment is that it would be worth looking to experiences in other markets for customer improvement measures. For example consideration might be given to reviewing the structure that recently came into force in Private Health Insurance, where benefit levels are given a Gold, Silver, or Bronze status. It may be feasible for three standard definitions to be developed for each relevant definition and for customers to be able to move between the levels.

For example a Gold TPD definition would be the most generous in terms of cover but come at higher cost, whereas a Bronze TPD definition would be less favourable in terms of cover but come with a lower cost. Trustees could be permitted to set the default level of cover, so allowing them to retain a degree of flexibility and choice in differentiating their insurance offering to suit their membership demographics and their own insurance eligibility and claims philosophy, while letting customers make the final decision as to which level suits them best.

About MLC Life Insurance

MLC Life Insurance, which traces its origins back to 1886, insures more than 1.5 million lives and is still fulfilling its original goal: “to bring the security and protection of life assurance within the reach of every man, woman and child”.

On 3 October 2016 National Australia Bank Limited (NAB) completed its sale of 80% of its interest in MLC Limited (MLC Life Insurance) to the Nippon Life Insurance Company (Nippon Life). This has led to the creation of a specialised life insurance business, MLC Life Insurance, where Nippon Life has a majority 80% holding, while NAB retains 20%.

At 31 December 2018 MLC Life Insurance had a market share of approximately 11%, making us Australia's third largest life insurer. Traditionally our focus has been on the retail market segment where policies are sold via financial advisers, but our involvement in the insurance in superannuation market is growing. At 31 December 2018 our group insurance in-force premium totalled \$560m, equal to a market share of approximately 8%¹. We are seeking to grow our presence in this market, particularly in the important industry superannuation fund segment, to which we are bringing new innovation and competition.

Regardless of channel, our products play an important role in protecting our customers, their families and businesses against the adverse financial impacts of premature death, illness, injury or disability. In the year to 31 December 2018, we paid \$1 billion in claims for our customers and their families, in doing so reducing or removing the need for people to rely on community support to manage their financial needs and responsibilities.

With the strong backing of Nippon Life, MLC Life Insurance is now poised to deliver even better value for its customers. The strategic partnership with Nippon Life has enabled us to invest over \$500 million in technology to simplify and improve the customer, member, trustee, adviser, banker and employee experience. This will result in our insurance products being easier to understand and administer. Digital channels and data analytics form a key part of our strategy. We are investing to simplify our back-office systems, including sales, servicing, underwriting and claims, to make it easier and faster for our customers, partners and communities to work with us.

¹ NMG Consulting, *Group Channel Risk Distribution Monitor*, February 2019

Responses to discussion questions

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

Standardisation of terms and definitions should increase the ability of customers to understand their insurance and to compare insurance coverage and offerings across different MySuper products. This will aid those customers who are looking to consolidate superannuation accounts or change funds, and for whom insurance arrangements is a factor in this decision.

However there are likely trade-offs to achieving this goal, and consideration should be given to the following matters:

- **Standardisation of terms and definitions is likely to result in an unequal allocation of costs and benefits amongst customers.** In other words, standardisation is likely to create winners and losers. Depending on the starting position of terms and definitions for a particular MySuper product, moving to standardise these terms would inevitably lead to either:
 - a higher claims threshold and therefore a higher rate of declined claims, but lower premium rates, or
 - a lower claims threshold, with a lower rate of declined claims, but with upwards pressure on premium rates.
- **Insurers work on different “pooled rating” bases, based heavily on the overall membership pool experience and demographics.** Because each risk pool’s demographics and occupational factors will remain unique, standardisation of terms and definitions will not lead to a standardisation of premium rates. Standardisation of eligibility and pre-existing condition exclusion definitions would also impact on the underlying costs, so there would need to be clarity and certainty around how these two aspects are defined.
- **Possible impacts on the market dynamics of insurance in superannuation.** Standardising definitions could lead to the commoditisation of insurance in superannuation, restricting the ability of trustees to differentiate their insurance offering to suit their own membership profiles, restricting their ability to differentiate themselves from other funds, and restricting the ability of insurers to compete for superannuation fund business based on innovation or product features. This could lead to insurers exiting the insurance in superannuation market, further concentrating this segment of the Australian life insurance market, which over the long term would result in diminished competitive pressure and the benefits this brings to consumers.
- **Other factors** that should be taken into account:
 - There is a cost for trustees to manage the constant changes occurring in the regulatory landscape, and ultimately these costs are passed on to customers through the fees charged in administering the MySuper products.
 - Customers are unlikely to be happy with any increased costs or diminution of cover due to standardisation.
 - Financial costs of system changes and any increase in administration costs that might occur will eventually accrue to customers.

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?

One avenue to inform prioritisation is to give consideration to which terms and definitions have been the drivers of complaints received by the Australian Financial Complaints Authority (AFCA). Generally speaking, we expect most complaints are likely to stem from issues surrounding eligibility to claim, or disputes around meeting relevant disability definitions. In the latter case, we do not believe that the dispute necessarily arises because of an absence of standardisation but rather disagreement over whether the available medical evidence supports the member's health condition meeting and continuing to meet the policy definition, so that the benefit may be paid or continue to be paid.

With group insurance providing cover based on an automatic basis, it is often a significant hurdle for a member to understand whether they are "eligible" for unrestricted cover. Often eligibility is driven by employment contracts/terms, the member's work capability upon joining, or whether they have undertaken a choice of fund decision since joining their most recent employer.

Existing standardisation

It should be noted that a degree of standardisation already exists in the insurance in superannuation market. Standardisation in definitions already exists due to align disability definitions with conditions of release under superannuation regulations. Further, reinsurance arrangements in the industry also ensure a degree of similarity across insurance contracts.

There is also a form of standardisation arising from takeover rules in group insurance, whereby an incoming insurer for an employer is required to provide terms that are no less favourable than those provided by the outgoing insurer. This ensures there is continuity of terms or the even more advantageous terms for members as the employer moves across insurers and funds. It follows that takeover terms alongside of the tender process results in a contract the terms of which have been maximised as much as is possible to the advantage of members by the employer and the fund.

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?

TPD definitions for cover offered in superannuation must align with the permanent incapacity condition of release. That being said, we do not believe there should be strengthening of this alignment, which is an obstacle to trustees being permitted to offer TPD insurances that differ from the definition of permanent incapacity in the SIS Act.

The law has interpreted permanent incapacity strictly so that the socio-economic conditions and geographic location in which the particular member finds him/herself is also a relevant consideration for the issue of the member's permanent incapacity in addition to his/her education, training and experience. The fact that a member could be reasonably re-trained to obtain employment is not a relevant consideration for a finding of permanent incapacity.

Changes in employment dynamics in the years since the definition was introduced means that employment is now more transient, with people moving between employers and industries and/or holding down numerous jobs across a number of employers. In addition, the community's capability and willingness to place a disabled person in gainful employment has greatly expanded. As a result, the finding that a person is disabled for the purpose of their employment at a particular point in time no longer rules out finding continued employment elsewhere.

For this reason, the current legislated definition of ‘permanent incapacity’ is generally seen by the industry as being too low a threshold in terms of claims outcomes and a threat to the long term viability of life insurance in superannuation. Using such a definition as a ‘standard’ definition would therefore be unaffordable and unsustainable for most superannuation schemes.

With this in mind consideration might be given to not only enabling trustees should be permitted to continue provide TPD insurances to consumers with a definition that varies from “permanent incapacity” but also consider the need to review the permanent incapacity definition generally. This approach will ensure a holistic approach to the issue of permanent disability that balances the needs of members, employers, the trustee and insurers. A balanced approach would allow trustees too provide support to consumers members at a time when their need is greatest, and in order to suit the particular demographics, occupation profile and therefore at the same time maintain retirement balances and insurance affordability, for of their members.

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

We believe allowing TPD definitions to take into account rehabilitation or return to work initiatives is a suitable principle to adopt, as it permits a more objective assessment to be made as to the likelihood of a potential claimant returning to the workforce in the short term. This approach preserves the underlying public interest of only allowing a member to access their superannuation funds under exceptional circumstances, when it is clear they will not be able to continue working until the normal retirement age.

Consideration should also be given to whether the legal prohibition preventing life insurers from paying directly for healthcare services which would help a consumer return to the workforce remains appropriate. This is particularly significant issue where early access to medical and rehabilitation programs can result in a different outcome in the member’s ability to return to work. Presently such a payment would be considered a program providing ‘hospital treatment’ or ‘general treatment’ according to the Private Health Insurance Act 2007. Removing this prohibition could be applied, for example, in scenarios where a consumer does not hold private health insurance cover at all, or does not hold the right level of private health insurance cover to pay for the relevant healthcare treatment or the gap is particularly high.

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?

The application of specific exclusions should not be made universal. Depending on the demographics and occupation profile of a particular fund, mandating the same exclusion for all funds could result in very high claims decline rates at specific funds. For example, mandating a suicide exclusion may result in a high decline rate at funds with a higher prevalence of mental illness, so would not be in the best interests of the fund’s members.

That said, the role of exclusions is to define the risk and keep consumer’s premiums affordable and accessible. Consequently, there may be value in developing standardised wording for a particular exclusion should a trustee wish to utilise it. In the suicide example, if a trustee wishes to use such an exclusion it may be beneficial for such an exclusion to be worded in a consistent manner across providers.

Examples of fairly common exclusions where consistent wording (but not universal application) may be useful include:

- Pre-Existing Condition Exclusions (PECE’s) (sometimes referred to as Limited Cover)
- Criminal or illegal activity

- War
- Self-harm / suicide
- Normal / Uncomplicated Pregnancy.

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

As outlined in the opening statement, trustees and insurers are yet to fully understand or absorb the impacts from other recent policy reforms, including PYS. As such, depending on the scope of reform we would suggest a three year minimum implementation period.

Considerations in implementation time should allow for:

- determining pricing implications, in particular the ability for suitable data to be made available to accurately model the pricing impacts of the changes
- adequate time for trustees to scrutinise and approve pricing and product changes, and to benchmark them against the market if desired
- third-party administrator implementation timeframes (typically one year minimum)
- existing rate guarantee periods (typically one to three years)
- consumer communication requirements
- implications for other obligations such as group takeover terms.

Consideration should also be given to customer confusion if the basis of insurance within super is in a constant state of flux. Constant change may be counter-productive and could result in even lower engagement in insurance than the industry is experiencing at present, similar to the 2014 amendments to the Insurance Contracts Act which were allowed an extensive and phased three year transition period.

A three year implementation period will also permit trustees and insurers to coordinate the required system changes with other changes that may also be unfolding in the same period, and to coordinate customer communications in such a way as to educate and minimise confusion.

Approach

Implementation of reform could be achieved within the purview of the Life Insurance Code of Practice, where the obligation would be placed on the insurer. It will enable insurers, through their industry association (the Financial Services Council) to work toward such standardisation. With the exception to the permanent incapacity definition in superannuation law, we do not believe the standardisation of terms is an obligation that is generally impossible on the trustee as terms, definitions and exclusions are within the insurance contract issued by the insurer.

In addition or alternatively, reform can be by amendment to current legislation, principally the Insurance Contracts Act and its regulations.

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

The relationship between terms and definitions on one hand, and premiums on the other, is generally that:

- where a term or definition has a greater impact on claims outcomes, the impact of standardisation on premiums will be higher

- where a term or definition has a lesser impact on claims outcomes, the impact of standardisation on premiums will be lower.

It follows then that standardising claims sensitive definitions such as TPD, terminal illness, total and partial disability could have significant cost impacts, depending on a fund's demographics and occupation profile.

From a premium perspective, standardisation of terms and definitions is likely to impact unequally on customers. Depending on the starting position of terms and definitions for a particular MySuper product, moving to standardise these terms would inevitably lead to either:

- lower premium rates, where the standard terms and definitions represent a higher claims threshold and lead to a higher rate of declined claims, or
- higher premium rates, where the standard terms and definitions represent a lower claims threshold and lead to lower rate of declined claims.

We also note that trustees already have an obligation to ensure the premiums they charge members are appropriate to the demographics of the membership base. A trustee would generally not consider a negative impact on its members as being in their best interests (depending on the extent of any price change based on the benefits of the standardisation).

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

Removing the ability for trustees to tailor their insurance offering to suit the specific needs and profile of their membership could have unintended consequences. For example, if too much upward pressure is put on premium rates, a trustee may have to offset this by reducing benefit coverage to such an extent as to make the coverage insufficient for the average member's needs. This could be particularly problematic for a fund with a hazardous occupation profile, where obtaining cover outside the fund may not be possible for individual members.

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

The impact on premium pricing could be mitigated by:

- Giving consideration to introducing a similar tiering structure as to that which recently came into force in Private Health Insurance, where benefit levels are given a Gold, Silver, or Bronze status. Standard definitions could be developed for each relevant tier, e.g. a Gold TPD definition that is the most generous in terms of claims outcomes but which comes with the highest cost, versus a Bronze TPD definition which is the least generous in terms of claims outcomes but which comes with the lowest cost. Trustees would then still have a degree of flexibility and choice in differentiating their insurance offering to suit their membership demographics and their own insurance claims philosophy.
- Consideration will need to be given to allow sufficient flexibility within the standardisation rules to not stymie innovation in future insurance design. For example, providing TPD payouts in instalments (as is presently the case in at least one insurance in superannuation product on the market) should be allowed to continue, as this design was developed to specifically meet the needs of that fund's particular membership profile.
- Providing adequate implementation time to minimise system change risks and costs and to allow trustees/insurers to educate and inform their customers.

- If mandated definitions – allow trustees to implement on a staggered basis with appropriate communication as to why definitions are changing.
- If minimum standards of definitions are applied then allowance for trustees to have definitions that are considered better than the minimum standard imposed.
- Allow sufficient timings for rate guarantee periods to expire naturally.

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

Generally speaking, repricing a scheme would take approximately 8-12 weeks at a minimum, provided all relevant data has been collected. Timings may vary depending on the size and complexity of the scheme, as well as the extent and complexity of any changes being sought to terms and conditions.

An undertaking such as this, moving to standardised definitions, would be considered a significant change, and the maximum possible time would need to be given in order for pricing actuaries and appointed actuaries to gain sufficient confidence in their modelling and assumptions.

If insufficient time is given, then insurers may need to adopt conservative assumptions to avoid concerns around claims volatility and uncertainty about future claims outcomes, based on the new standardised definitions. This would likely result in customers paying higher premiums until insurers are able to refine them based on actual claims experience.

Most insurance in superannuation policy guarantee no increases in premiums for period of time, usually two or three years, however it's not unusual to see requests for longer guarantees, e.g. up to five years. A fund is therefore unlikely to be able to act in the best interests of members by passing on an increase in premiums rates earlier than the end of the guarantee period.

Sufficient timing would also be required to allow for:

- trustee approval processes
- administration system changes
- relevant member communications.

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?

We are not certain if standardisation will improve understanding. It may enhance confidence in that the member has certainty certain terms will remain the same irrespective of which superannuation fund their default insurances have been arranged. However, in our view, the standardisation of terms of themselves will not result in greater understanding.

We believe that a member's primary interest is knowing what cover they have and the amount of cover. This is directly informed to members via their annual (periodic) statements and/or fund annual reports. Consideration should be given therefore to improving member understanding and knowledge through those documents, for example by mandated information (such as an explanation of the covers the member has and when it will end). We believe that communication, such as annual reporting, will achieve better consumer knowledge outcomes than standardisation of terms. Similarly, consideration might be given to extending mandated communication obligations to employers.

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

Please see our response to question 11 for part of our overall response to this question.

In addition, presently a number of education and awareness initiatives are underway as trustees look to implement the Insurance in Super Voluntary Code of Practice (ISVCOP). Consideration should also be given to Australian Government funded education campaigns covering topics such as:

- education on how to claim in insurance
- education on the value and importance of life insurance to the general population/consumers
- making financial literacy a part of the school curriculum.

Technology improvements to allow members to access insurance easily and in a manner which suits them, and which is interactive, may assist in improving consumer understanding.

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?

Prescribing a *set level* of cover for all MySuper products would be inappropriate as it would fail to take into account the specific needs, demographic profile and affordability level of a particular fund. It may also create a conflict with a trustee's fiduciary duties at common law to act in the best interests of their members, as trustees would not be able to tailor what is provided to suit their specific membership.

However, prescribing a *minimum* level of both death and TPD cover is sensible as it would prevent the creation of junk insurance products. Minimum levels should be realistically set. The current prescribed minimum levels of death cover are far below what the vast majority of trustees offer to their members, and are therefore not really playing a meaningful role in determining the insurance provided. We note that considering that a trustee is obliged to provide default TPD cover as well, the present situation of only prescribing a death benefit amount appears incomplete.

A maximum level of cover is arguably unnecessary, as the vast majority of funds are adopting the ISVCOP which contains a provision to set cover at a level that does not exceed 1% of a member's salary. Consideration of setting a maximum level of cover should therefore also tie into the potential implementation of Royal Commission recommendation 4.9, regarding the enforceability of industry code provisions such as the ISVCOP.

Similar to the concept of set levels of insurance, legislating maximum levels of cover would also seem to create a conflict with a trustee's fiduciary duties at common law to act in the best interests of their members, as they would not be able to tailor what is provided to suit their specific membership

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

Research should be undertaken to demonstrate suitable insurance needs at various ages.

Minimum levels of cover should be automatically indexed to keep pace with inflation or some other measure, such as wage growth. Otherwise the minimum prescribed amounts will quickly become outdated.

It would also make sense to allow differentiation for funds with much heavier occupation profiles who may not be able to afford the minimum cover amounts - for example a minimum premium spend rather than a minimum cover amount.

As above, we don't consider it appropriate to prescribe set or maximum levels of cover.

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

We have no further comments on minimum, maximum or set level other than what is expressed in response to questions 13 and 14.