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ISWG – Project Management Office
c/-KPMG
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Dear ISWG Secretariat

FSC response to Insurance in Superannuation Working Group (ISWG) discussion paper on Account balance erosion due to insurance premiums

The Financial Services Council (FSC) has welcomed the opportunity to be part of the Insurance in Superannuation Working Group to collaboratively enhance future iterations of policy development for insurance in superannuation.

Many FSC members contributed to the Insurance in Superannuation Working Group's Discussion paper on Account balance erosion due to insurance premiums. Rather than respond specifically to the key questions raised by the discussion paper, we provide recommendations in a few areas where we believe this provides further insight.

About the FSC

The FSC has over 100 members representing Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks and licensed trustee companies. The industry participants represented by the FSC are responsible for investing more than $2.7 trillion on behalf of 13 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. The FSC promotes best practice for the financial services industry by setting mandatory Standards for its members and providing Guidance Notes to assist in operational efficiency.

The FSC and its members within this submission have provided recommendations to four key areas of the discussion paper: cessation, minimum level of cover, automatic insurance members and maximum premium levels.

Should you have any questions in relation to this submission, we would welcome the opportunity to discuss this further.

Yours sincerely

JESSE KRNCEVIC
Policy Manager

Introduction

The FSC as a member of the ISWG shares the view that group insurance in superannuation provided on an opt-out basis, has been a successful policy for Australia which has resulted in better risk protection for Australians. It also provides a safety net to millions of Australians who would not have otherwise chosen or would have individually been unable to take out life and disability insurance.

The FSC believes that it is important for group insurance in superannuation cover to align with member needs and be affordable, but acknowledges that some enhancements could be made to further improve the system. We are of the view that any reform should support ongoing sustainability and affordability of quality cover for members and have therefore highlighted that some of these reforms if poorly designed and implemented could conceivably have the unintended consequences of limiting access to quality insurance and increasing the cost of cover for members.

We are hopeful that our recommendations in this submission will contribute to addressing some of the key issues highlighted in the ISWG discussion paper on account balance erosion due to insurance premiums.

1. The objective of insurance in superannuation

On page 1 of the ISWG Foreword, the ISWG objective of insurance in superannuation currently states that:

"*The objective of insurance in superannuation is to provide a measure of financial support to members and their families if the member is prevented from working to retirement age by death or ill-health***."**

FSC members recognise that any public statement of the objective of insurance in superannuation has the potential to become the definition used by policymakers in future.

With this in mind, the FSC recommends that the current objective of insurance in superannuation statement be adjusted to incorporate temporary or permanent disablement, as well as including other types of protections insurance in superannuation provides.

"The objective of insurance in superannuation is to support the purpose of superannuation by providing a measure of financial support to members and***/or*** their families if the member is prevented from working, ***either temporarily or permanently,*** to retirement age by death, ***terminal illness, injury*** or ill-health."

2. Establish an industry standard for cessation of automatic cover due to low contributions, contribution inactivity or low account balances.

The FSC agrees with the proposal that there be industry guidance in relation to cessation, but this should be subject to the following principles:

- The guidance should place emphasis on income protection, due to set-off rules that apply for income protection;
- As each member (or their beneficiaries) are entitled to claim against multiple lump sum benefits, cessation of cover for lump sum benefits could occur in more limited situations. For example, if the member's account balance has dropped below a certain threshold and there is no contribution activity for an extended period. For administrative simplicity, the threshold could be aligned to the level used for lost members' accounts which is currently set at $6000. However, each fund could set the amount based on their own demographics and average account balance.
- The period of contribution inactivity should be greater than 12 months, for example 13 months. This is to ensure that late quarterly superannuation guarantee contributions are captured, and this would also cater for members who are on parental leave or other types of unpaid leave;
- We raise concerns with ceasing Death and TPD cover where a member may cease work due to ill health, even work part-time, be on a worker's compensation claim and not meet the definition of TPD during this period. These members, and their beneficiaries, will be significantly impacted by any proposal to cease cover creating both reputational risk and challenges for trustees and insurers with late notified claims (where there may be pressure to admit a claim but no premium for a period has been paid);
- There should be multiple attempts to contact and communicate with the member before ceasing cover, preferably across different types of communication channels.
- While we agree that industry guidance on cessation provisions would be useful and go some way to directly reducing the risk of inappropriate benefit erosion, the FSC is of the view that addressing the broader issue of multiple superannuation accounts is the appropriate avenue. By focussing on the reduction of multiple superannuation accounts, this will highlight unwanted multiple insurance leading to member directed cessation of cover.

3. Minimum cover levels

Section C of the discussion paper outlines some areas of improvement which would require legislative change. Section C.2 suggests that the current minimum levels of life insurance may be limiting trustees in delivering life insurance that meets member needs.

Under the current regulatory obligations[1], MySuper products must offer death and permanent incapacity benefits (generally known as TPD) on an opt-out basis, and must offer a minimum level of death cover. For example, for default members aged between 20 and 34, at least

[1] Superannuation Guarantee (Administration) Amendment Regulations 2005 (No. 1) - Regulation 9A

$50,000 of Death cover must be offered. There is no legislated minimum level of TPD cover which must be offered.

The FSC agrees that additional flexibility may be required, particularly in cases where trustees may want to offer a lower level of death cover for younger members, who generally do not have dependants or significant debt.

There are some factors which have caused trustees difficulty.

Changes in claims patterns, the increase in the number of claims that relate to a mental health conditions and consumer research which report members' desire to be supported and assisted to return to work where possible are all factors which have challenged trustees to provide an appropriate default insurance offering for their members. Greater flexibility should be extended to the type of cover which must be offered by trustees to members in its MySuper product(s).

More funds are now offering default income protection benefits, which potentially better supports assisting members return to work. For those already offering it as a default, many are extending the benefit period beyond the typical two year maximum to allow greater time to assist and the support the member. This is critical when many claims are lodged long after members stop work.

However while trustees are focused on providing affordable insurance to members without unduly eroding retirement income, they are forced to adhere to legislative requirements to provide a disability benefit which is consistent with the permanent incapacity definition. These restrictions inhibit trustees from tailoring insurance products to better suit their members' needs. However trustees under the current legislation must provide a disability benefit which is consistent with the Permanent Incapacity definition.

Any adjustment to the legislation should not extend to removing the requirement for trustees to provide life insurance cover to members.

The FSC recommends that legislative change should be undertaken which:

- reduces the legislative minimum level of death cover, particularly for younger members; and
- broadens the scope of the mandatory 'disability insurance' benefits that must be provided to MySuper members to include a benefit that meets either the permanent incapacity or temporary incapacity condition of release.

These changes would provide trustees with greater flexibility in tailoring benefits to suit particular member cohorts but also provides opportunity to offer income protection benefits rather than TPD benefits as a default which may be better aligned to assisting members back to work. This would not preclude funds from offering a TPD benefit, but provides greater flexibility to suit members.

4. The definition of ‘automatic insurance member’

The guidance ultimately provided to trustees in relation to erosion of account balances should be designed to capture members who joined a fund as a choice member, but who have insurance subsequently added on an opt-out basis.
The current definition of ‘automatic insurance member’ is defined as a member who “when joining a superannuation fund insurance is issued under an automatic acceptance limit”. This is subject to some exceptions, including if they “make an application for cover including through choice of fund”.

The FSC believes that this definition could have the unintended consequence that the proposals outlined in the Discussion Paper would not benefit members in funds where insurance has been added on an opt-out basis, rather than through applying to have insurance cover.

We recommend that the definition of ‘automatic insurance member’ be changed as follows:

- define ‘automatic acceptance limit’ to include all members who are provided with insurance cover as a condition of them becoming a member of their fund, unless they opt-out;
- clarify that the words ‘through choice of fund’ in the second exclusion, do not apply to choice of fund members who have had insurance cover unilaterally applied to them by the trustee on an opt-out basis; and
- Clarify that insurance premiums funded by the employer is for wholly funded premiums only and not partially funded premiums.

5. Maximum premium levels

Definition of ‘inappropriately erode’

The FSC supports establishing a standard definition of ‘inappropriately erode’ which, at a minimum, makes reference to the expected cumulative impact of insurance premiums on a member’s anticipated account balance at retirement. To satisfy this definition, trustees would be required to calculate the above amounts, and the Good Practice Guide should be provided to the industry on the methodology for making these calculations.

Premium thresholds

The FSC strongly agrees that thresholds be established within the Good Practice Guide that will ultimately govern maximum premium levels for different cohorts and address account balance erosion.
The criteria for these levels set out in the paper can have shortcomings if they were to be used in isolation.

We therefore do not support one individual method to the exclusion of others.

In our view, a percentage of account balance at retirement as a criteria to measure maximum premium thresholds would involve significant actuarial input and system changes and would therefore be too difficult to achieve.

For the purpose of establishing maximum thresholds, we therefore propose that the Good Practice Guide recommend thresholds reference the following criteria:

- A percentage of account balance, and
- A percentage of employer contributions, SG contributions, or salary, and
- A percentage of automatic insurance members who satisfy either of the above two tests.

The above percentages could be varied by trustees to suit different member cohorts or age bands.

These thresholds could be applied at the collective fund level, as opposed to the individual member level, and trustees would need to meet the thresholds if a determined percentage of members within each cohort meet the test.

With respect to timing, the above review should be applied at a frequency consistent with the review of the insurance arrangement itself as outlined in each trustee’s Insurance Management Framework.