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Committee Secretary
Parliamentary Joint Committee on Corporations and Financial Services
PO Box 6100
Parliament House
Canberra ACT 2600

Email: corporations.joint@aph.gov.au

Dear Committee Secretary,

INQUIRY INTO THE LIFE INSURANCE INDUSTRY

The Association of Superannuation Funds of Australia (ASFA) is pleased to provide this submission in relation to the Committee's inquiry into the life insurance industry.

About ASFA

ASFA is a non-profit, non-political national organisation whose mission is to continuously improve the superannuation system so people can live in retirement with increasing prosperity. We focus on the issues that affect the entire superannuation system. Our membership, which includes corporate, public sector, industry and retail superannuation funds, plus self-managed superannuation funds and small APRA funds through its service provider membership, represent over 90 per cent of the 14 million Australians with superannuation.

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If you have any queries or comments regarding the contents of our submission, please contact Ken Whitton on (02) 8079 0849 or by email kwhitton@superannuation.asn.au or myself on (02) 8079 0808 or by email gmccrea@superannuation.asn.au .

Yours sincerely

Glen McCrea
Chief Policy Officer

In this submission we have made comments with respect to terms of reference A, B, C, E and F of the inquiry focussing on group insurance held within superannuation.

The need for further reform and improved oversight of the life insurance industry

While ASFA is broadly comfortable with the legislative and regulatory framework in relation to death and disability insurances held in superannuation at this point of time, we have identified some opportunities for change that would improve the system and are looking at the framework as part of the Insurance in Superannuation - Industry Working Group.

The current regulatory settings are relatively new in many areas and resulted from a comprehensive review of superannuation in 2010[1] (the Cooper review) and a subsequent package of reforms[2] (Stronger Super). Recent issues relating to claims handling practices for example, have highlighted the need for improved standards being applied across the industry and stakeholders, inclusive of the regulators[3], have taken action in this regard.

Industry Working Group

An Industry Working Group has recently been established (comprising superannuation associations, funds, insurers, consumer representatives and other stakeholders) to collaboratively address a range of issues and to codify practice and/or conduct standards for insurance held in superannuation.

Building on the existing Life Insurance Code of Practice[4], it is intended that obligations for both superannuation funds and insurers will apply and these will be binding, enforceable and have mechanisms for independent administration and monitoring to enhance consumer protections. The intention is to finalise the code before the end of 2017. However improvements to industry practice will be progressively delivered throughout 2017, extending on the progress made since the Stronger Super reforms.

Productivity Commission Inquiry

In addition, the Productivity Commission is currently undertaking an Inquiry into the Efficiency and Competitiveness of the Superannuation System[5] and insurance is one of the key objectives upon which the system is being assessed.

ASFA expects that once this inquiry is completed, the industry will be better informed in regard to whether further reforms and improved oversight is required. In our submission[6] to that inquiry we highlighted some areas where legislative change might be desirable.

[1] Super System Review 2009/10 – Review into Governance, Efficiency, Structure and Operation of Australia's Superannuation System.
[2] Stronger Super – the then Labour Government response to the Super System Review.
[3] 12 October 2016 – APRA sets expectations for superannuation fund trustees and insurers for improvements to claims handling. ASIC issues industry review (REP 498) of life insurance claims.
[4] 11 October 2016 – FSC Life Insurance Code of Practice.
[5] How to Assess the Competitiveness and Efficiency of the superannuation System – Draft Report August 2016.
[6] ASFA – submissions to Productivity Commission – Superannuation Efficiency and Effectiveness 2016.

Opportunities for legislative reform – rehabilitation

The limited, somewhat 'all or nothing', nature of the regulatory definition of total and permanent disability (TPD) has led to difficult, and sometimes protracted, decision-making for funds. In particular the regulatory definition does not provide for the possibility of subsequent rehabilitation or recovery, or for future changes in technology, that may permit a member to return to work.

There is evidence that framing a person's medical condition in terms of their 'disability', as opposed to their 'ability', can have a deleterious effect on their psychological condition. Furthermore, the 'one time' assessment as to disability can, in some circumstances, act as a disincentive for a member to recover some ability, as this may cause them to miss out on being paid a lump sum TPD benefit.

ASFA considers that members' best interests could be served by modifying or removing the regulatory impediments that prevent insurers from providing targeted rehabilitation benefits and/or staged payments to members that would assist them to return to the workplace.

Opportunities for legislative reform -taxation impediments

It is also important to consider the distortive effect of the regulatory settings with respect to the taxation of insured benefits inside and outside superannuation. While it is more cost efficient to provide death and TPD lump sum insurance through superannuation, the differing tax treatment of benefits paid out can lead to significant differences in the amount of the net benefit received by the member/beneficiaries.

Part of lump sum TPD benefits (before age 60) and all of death benefits (to non-dependants) paid from superannuation funds are subject to tax at a rate up to 32 per cent, whereas death and TPD insurance payouts made outside superannuation are generally tax free in the hands of the recipient.

The benefits of insurance in superannuation could be improved by providing tax treatment more equivalent to non-superannuation arrangements.

Assessment of relative benefits and risks to consumers of the different elements of the life insurance market, being direct insurance, group insurance and retail advised insurance

i. Relative benefits of group insurance in superannuation

For most Australians the insurance they have in their superannuation is the only life insurance they hold. The provision of group insurance in superannuation is therefore a crucial part of the system supporting Australians who suffer a health-related misfortune. This cover enables members to manage the financial risks associated with disability and death during their working life whilst also supporting substantially improved retirement outcomes for claimants.

Currently, superannuation insurance arrangements amount to:

- 71 per cent of total death sums insured in the community
- 88 per cent of total and permanent disability sums insured
- 59 per cent of total income protection/salary continuance/total but temporary disability benefits insured

Addressing underinsurance

Insurance in superannuation alleviates systemic underinsurance and the potentially devastating economic implications for individuals and their families who face disability or premature death, whilst also reducing the level of social security benefits payable due to a lack of coverage.

It is worth considering that despite the wide coverage provided through superannuation funds, the level of underinsurance remains high. The median level of life cover meets about 61 per cent of the basic needs for average households – and for families with children it is a much-lower 37 per cent of needs[7] .

The impact of underinsurance on increasing social security payments is significant. An analysis of aggregate insurance held by the working community inside and outside of superannuation estimates the cost to government of increased social security payments arising from underinsurance to be in excess of $1 billion per annum comprised of:

- $60 million per annum for death cover
- $840 million per annum for total and permanent disability (TPD) insurance
- $140 million per annum for income protection insurance[8]

The impact of underinsure on social security expenses would be much higher without insurance in superannuation given the majority of cover across all of these insurance types is held through superannuation. In addition, there is a significant further cost through lost economic production and resulting income tax in respect of partners ceasing work to care for the family.

Providing access to cover that may otherwise be unaffordable

Group insurance is based on a pooling of lives that, in the absence of individual medical underwriting, includes a selection of both good and bad risks. This means that members who may have pre-existing medical conditions, work casually or part-time, or work in high risk occupations, are generally able to access insurance cover. Access is through group arrangements at an affordable price without the imposition of restrictions, exclusions or premium loadings – or even denial of cover - if they were to be underwritten for individual cover.

Life and disability insurance cover held in superannuation accounts typically has lower premiums than comparable policies held outside superannuation. The premium for a given level of cover is lower across age categories between 30 to 60 years, for both genders, inside superannuation. The difference in premiums ranges from approximately 25 per cent to 55 per cent less for females increasing with age. For males this benefit ranged from approximately 35 per cent to over 60 per cent also increasing with age[9].

[7] Rice Warner 2014, *Insurance Administration Expenses*.
[8] Rice Warner 2014, Insurance Administration Expenses.
[9] Rice Warner 2016, *data sourced from a sample of ten superannuation providers and thirteen insurers for a professional occupation member with $1,000,000 sum insured for death and TPD 'any' occupation.*

Providing cover where individuals would not otherwise have cover in place

The evolution of group insurance over the past 20 years has seen up to 92 per cent of the working population[10] afforded some type of insurance coverage that would otherwise not be in place.

While member engagement with insurance in superannuation is typically low, some ASFA members have reported to us that up to 15 per cent of members 'opt-up' and increase their default level of insurance cover, whilst less than 5 per cent 'opt out' and cancel their cover. This behaviour indicates that fund members associate a high degree of value and benefit with insurance in superannuation and that for many individuals increased levels of cover are required to meet their needs.

Providing individuals support through their claim beyond simply financial benefits

Superannuation funds, together with insurers, have increasingly extended the support services offered to members through occupational rehabilitation and return to work support. This is a reflection of the desire of all stakeholders to see the individuals return to work in some capacity where possible. Not only does this give the individual a sense of purpose, it also ensures they can continue to earn an income and save for their retirement, further reducing the drain on the public purse.

Insurers have also extended their services to look at preventative measures, focusing on the health and wellness of individuals, to help them avoid or minimise the impact of preventable illness and injury. This includes investment in stay at work and absence management programs.

As mentioned above, some modifications to the regulatory framework relating to TPD insurances would allow these services and programs to be extended further.

ii. Risks to consumers of group insurance in superannuation

It is clear that the recent experience of some individual claimants has fallen short of community expectations. Increasing consumer protections and uniformity of practice is essential to ensure valuable protection is provided to Australians in a fair and sustainable manner.

ASFA believes that these matters can be addressed by the aforementioned Industry Working Group and subsequent development of an additional set of standards pertaining to superannuation funds and insurers that will set the benchmark for industry practice into the future. There is a need to identify what improvements can be made to drive the best possible consumer outcomes and to implement the required changes.

The Industry Working Group is in the process of determining its detailed scope of work. However the following issues certainly will be addressed:

- Governance arrangements
- The effect of premiums on member balances
- Benefit design and policy terms
- Claims handling and dispute resolution
- Data standards and reporting

[10] Rice Warner 2015, *Underinsurance in Australia*.

Whether entities are engaging in unethical practices to avoid meeting claims

APRA has indicated that they have "no problem" with the practices that are best described as "risk sharing arrangements" between insurers and superannuation funds[11]. Some commentators have implied that these arrangements encourage funds to avoid claims. However there is no evidence of this occurring in practice.

"Risk sharing" recognises the actual performance of a policy held by a superannuation fund on behalf of its members relative to its underwriting criteria, resulting in a smoothing of premiums for members over time. These arrangements also increase member access to information, education and health initiatives which have shown to improve group policy performance and sustainability.

Recently heightened governance requirements for superannuation funds act as a deterrent to unethical practices. Firstly, there is a specific Trustee covenant in the SIS Act in relation to Insurance in Super.

Superannuation funds also have a legal obligation to ensure that any arrangement entered into is in the best interest of the members. Such arrangements need to be contained within a fund's Insurance Management Framework and be in line with APRA's Superannuation Prudential Standards. Potential conflicts are commonly managed by separation of duties and delegations amongst other mechanisms.

The effectiveness of internal dispute resolution (IDR's) in life insurance

ASFA contends that in assessing the effectiveness of internal dispute resolution (IDR) frameworks, the member experience is of paramount importance. A first consideration is the ease upon which members can access information about the IDR process. In this regard the level of information that is made available on providers' websites does vary greatly, and is not always prominently featured. This is an area that could, in ASFA's view, be improved.

In ASIC report 498 - Life insurance claims: An industry review, proposals were made to "strengthen the consumer dispute resolution framework for claims handling". These proposals included reference to the current inquiry into dispute resolution schemes [12](The Ramsay Review), recommending that the coverage of life insurance claims by dispute resolution schemes is considered in its review. In particular more effective consideration of fairness is required, as is providing better access to consumers with complaints about delays in claims handling and ensuring better remedies when these complaints are in the favour of the member. ASFA is supportive of the proposals made by ASIC and we look forward to the Ramsay Review report due for release in March 2017.

The roles of the Australian Securities and Investments Commission and the Australian Prudential Regulation Authority in reform and oversight of the industry

Both ASIC and APRA undertake robust supervisory efforts in relation to overseeing insurance provided in superannuation. Similarly, they both engage and consult regularly with industry to identify when reforms are needed.

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[11] Helen Rowell – House of Representatives Standing Committee on Economics 14/10/16.
[12] Treasury – Review of the Financial System External Dispute Resolution Framework 2016

APRA ensures that funds meet the requirements of Superannuation Prudential Standard 250, including but not limited to them having an Insurance Management Framework and an Insurance Strategy. APRA also has the prudential supervisory responsibilities for life insurers.

Regular thematic and other reviews undertaken by APRA focus on the industry and as a result improvement progressively become realised. APRA has spelt out its priorities with insurance in superannuation for the near to medium term, including a focus on organisational culture and conduct, sustainability and improving governance and transparency[13] .

ASIC has similarly been paying close attention to this segment of the insurance industry as has been mentioned by reference to its recent review and report into claims handling.

In addition to strengthening the dispute resolution framework for claims handling, the following actions to raise standards will be progressed by ASIC in 2017:

- Public reporting of life insurance claims data
- Strengthening the regulatory framework for claims handling
- Follow up ASIC surveillance and reviews
- Strengthening industry standards and practices

It should be recognised that the issues of greatest significance for ASIC in its review and report into claims handling were not related to group insurance in superannuation.

[13] APRA Corporate Plan 2016-2020