

Mr Jim Minto,
Chairman
Insurance in Superannuation Working Group

By email: ISWG-PMO@kpmg.com.au

20 October 2017

Dear Mr Minto,

AFA Submission on Insurance in Superannuation Code of Practice

The Association of Financial Advisers Limited (AFA) has served the financial advice sector for 70 years. Our objective is to achieve Great Advice for More Australians and we do this through:

- advocating for appropriate policy settings for financial advice
- enforcing a Code of Ethical Conduct
- investing in consumer-based research
- developing professional development pathways for financial advisers
- connecting key stakeholders within the financial advice community
- educating consumers around the importance of financial advice

The Board of the AFA is elected by the Membership and all Directors are required to be practising financial advisers. This ensures that the policy positions taken by the AFA are framed with practical, workable outcomes in mind, but are also aligned to achieving our vision of having the quality of relationships shared between advisers and their clients understood and valued throughout society. This will play a vital role in helping Australians reach their potential through building, managing and protecting wealth.

Introduction

The AFA welcomes the opportunity to provide feedback on the Insurance in Superannuation Working Group (ISWG) Consultation Paper on an Insurance in Superannuation Code of Practice.

We believe that the paper could better set out the purpose to the Code and the factors that lead to the impetus to develop it. Expressed simply - why does the ISWG believe that a Code is required and what are they trying to achieve by establishing this Code?

It is our interpretation from the Consultation paper and the draft Code that the ISWG is placing greater weight on avoiding premiums that may provide unnecessary insurance rather than prioritising access to insurance cover. This is an important philosophical position and if the ISWG believes that it is better to focus upon avoiding unnecessary premiums above the risk of members not having cover when they need it, then the ISWG should more clearly articulate their view.

One critical point that we would like to bring to your attention is the apparent lack of consideration of the critical role that financial advisers play in advising members of superannuation funds with respect to their insurance needs. The consultation paper and the Draft Code barely even refer to the role financial advisers play in supporting members or the importance of financial advice. There can be no question that the best outcome for members of superannuation

funds, in determining their insurance needs, is to talk to a financial adviser and obtain financial advice. What has been proposed in this Code in terms of a premium limit and the termination of insurance after a period of no contributions is a crude rule of thumb approach to managing what is often a critical protection measure for financial security. Any unilateral action to restrict the level of insurance cover or to terminate cover needs to be very carefully considered. The consequences can potentially be enormous.

It is apparent that advised clients would still be covered under the scope of this Code, even if the extent of the coverage was reduced. In this regard it is important that the trustees acknowledge the role that the financial adviser plays and that they commit to sharing information with financial advisers as a part of implementing any measures with respect to this Code

We recommend that the Code specifically recognises that the best option for members in determining their insurance needs is to obtain financial advice.

It would appear that to some extent the trustees might be assuming that they can provide advice to their members. The frequent use of the word “appropriate” in the document appears to suggest that they anticipate an increased role in the provision of advice. We would like to express caution in this as most trustees do not have access to the required financial advice resources. It is also very important that the trustees consider the potential legal consequences of actions that might appear to represent the provision of financial advice.

We are also very conscious that the measures in this Code will likely lead to a significant increase in costs if implemented as proposed. We will talk further below about some of these measures, however at the outset it is important to appreciate that these changes will drive an increase in costs and therefore an increase in the fees paid by members.

The Basis for Determining the Need for and Level of Insurance

The correlation between a member’s Income and the need for insurance is likely to be very weak. The true indicators of the need for insurance are factors such as the existence of debt (typically a mortgage), marital status, the presence of children and lifestyle. To some extent these factors could be offset by access to assets, including superannuation. Age alone is no guide to the need for insurance. A 23 year old could easily have a large debt, a spouse and three children. Such a person has a much greater need for insurance, not a lower level of need.

It is reasonably common for financial advisers to advise clients, where health issues may exist, to hold their existing insurance within a particular fund, even though they may now be contributing to a different fund. This might be on the grounds that they would otherwise not be able to obtain underwritten life insurance due to health issues. It might also be the case that an employee has transitioned to a self employed arrangement and they still wish to hold the insurance within the fund, even if they have ceased actively making contributions. This Code will put the insurance arrangements of each of these groups at risk, either because the premium limits will impact upon the level of cover or because the insurance will be terminated after 13 months of no contributions. Whilst the Code does include a requirement for the provision of letters to the member on the proposed cancellation of insurance, this might not get through to the member, might not be opened or might not be actioned. In any case a positive response from the member should be obtained before the cover is ceased. Additionally, as many members rely on their annual statement as the source of truth, there will be many members whose last statement indicates that they have active insurance cover, even though it has been subsequently terminated.

The AFA is very much aware of the current debate around whether insurance inside super for default members should be on an opt-in versus an opt-out basis. It is our view that a move to opt-in would have a huge impact, significantly increasing the level of underinsurance and reducing the level of engagement in superannuation. An awareness of the value of life insurance is typically only fully appreciated at the time of claim or with the benefit of financial advice.

This is most applicable to young people who more often have little interest in appreciating the consequences should something major happen to their health or livelihood, that either potentially qualifies for a claim or as a minimum makes them uninsurable in the future. Default insurance, for many, is the only protection they have.

In our opinion, some of the measures in this Code are likely to lead to a reduction in the level of insurance cover that Australians have, particularly in the absence of more people getting advice. As a direct result, this is likely to lead to more people becoming physically, emotionally and financially distressed and most likely reliant on the social security system and therefore a significant increase in government expenditure.

Scope of the Code

1. How should the ISWG ensure that all trustees are bound by the Code?

For the Code to be effective it is essential that it is mandatory for all APRA superannuation funds. The AFA notes that there are two key options:

- Legislation to mandate compliance with the Code.
- Mandatory membership of an industry body that can enforce compliance with the Code.

The strength of any such system can be judged by the extent to which it is possible to avoid compliance. This would then further complicate the situation by opening up an unlevel playing field amongst superannuation funds, particularly with respect to operating costs. It is therefore important that if the industry proceeds with the implementation of such a Code, that they find a means for making it mandatory.

2. What are the practical implications of the transition arrangements?

This is probably a matter for the funds to address, however it is important to consider the implications during the transition year, if some trustees commence compliance earlier than others and the potential issues with different processes and levels of knowledge as different funds progress at different rates.

It is also noted that the planned commencement date is only eight months away, which does not leave much time to finalise the Code and for trustees to start to prepare for implementation, even though there is a twelve month transition period.

3. What flags will be required to be built into a trustee's (or their administrator's) system as a result of the Code requirements (for example, whether a member is an Automatic Insurance Member, whether they have chosen to retain their cover even when not making contributions, whether they require assistance as a vulnerable consumer)?

We believe that this process is an important trigger for trustees to consider their administration systems and the need to capture additional member data. At the outset we would suggest that consideration be given to the following:

- The member's financial adviser and their contact details.
- Whether the member is married or not.
- Whether the member has children or not.

- Whether the member has a mortgage or not.
- Whether this fund is their chosen fund for life insurance.

In addition, the items raised in question 3, such as choices to retain cover and vulnerable person status (native language, interpreter needs etc) should all be added to the membership system records.

Appropriate and Affordable Cover

Premium Limits

4. Are there alternative proposals for setting maximum premium levels that the ISWG should consider?

The AFA is very concerned about making such important decisions on the basis of an assumption about the level of income that a person has. We envisage that this could become particularly complex when it comes to people with multiple part time jobs, or a part time job and a business.

It seems that the purpose for setting a premium limit or cap has not been clearly defined. What is the objective of such a measure and what are the risks that need to be managed? This does not appear to be articulated.

We are also very conscious of the fact that the cost of insurance goes up as someone ages, so a broad-based approach such as the one proposed will mean that insurance levels will naturally decline very rapidly as people get older. This most probably will not align with people's needs, particularly in the context of the recent increases in the levels of debt and the fact that most people still retire with a mortgage.

It is not apparent to us that the ISWG have investigated the consequences of such a measure in terms of how many people might be impacted and what is the overall level of the reduction in cover that may result. This is a very important decision for trustees to make on a unilateral basis and it should be backed up by a body of evidence.

We do not believe that there is any substitute for genuine financial advice. Even if an alternative approach based upon a cap on the percentage of contributions was applied, this would not work for people who contribute to another fund or who were out of work for a period during the year.

We are also concerned about the proposed lower limits for people under the age of 25. This is an arbitrary threshold that does not take into account the members family composition or level of debt. A lot of young people die under the age of 25 for a range of reasons. Is it wise to deprive their families of the financial protection that might otherwise be provided by access to insurance through their superannuation fund?

5. Are there particular measures of earnings that the ISWG should include in Good Practice Guidance?

Some funds may have access to income information, however it is expected that many won't and that for some members it will be extremely difficult to determine what their actual income is. It is also noted that for many people income is a very confidential piece of information and they may not be happy to share this with others, including their superannuation fund.

6. Question for Superannuation Funds

7. What impacts are the premium limits likely to have on benefit design and premiums? Are there financial impacts that the ISWG should take into account?

As the cost of insurance goes up over time, and that is certainly the trend that we have seen in recent years, such an approach will mean that the level of insurance cover needs to be reduced each year, even for younger people. This is likely to be quite confusing for impacted members. We would also be concerned if this resulted in trustees making decision about the comprehensiveness of cover on the basis that a reduction in included terms will enable a higher level of cover. As it is, the type of cover in Group superannuation insurance arrangements is often suboptimal, particularly with respect to TPD terms.

We envisage that benefit design for those under 25 will become particularly challenging as trustees and insurers are forced to make trade-offs between the level of cover and the terms of that cover (for TPD and Income Protection).

8. To what extent will the premium limits achieve the goal of targeting inappropriate account erosion for low income earners, particularly women and younger members?

The use of the term “inappropriate account erosion” includes an implied judgement that a certain level of cover is appropriate, but possibly a higher level of cover is not appropriate. We question the ability of trustees to make this determination on the basis of the limited amount of information that they often have.

The proposed cap of 1% of income, is approximately 10.5% of SGC contributions for any employee who is eligible to receive SGC contributions. For anyone under the age of 25, it is roughly 5% of SGC contributions. In both cases this is a very moderate level of expenditure on insurance and would therefore not be considered to cause inappropriate account erosion.

9. What are the likely impacts of a trustee reducing cover for some segments of its membership in order to reduce premiums? How would the trustee manage a member who wanted to retain their original cover? Could this member remain an Automatic Insurance member?

We envisage that it would be quite likely that under the proposed premium limits, trustees would need to make decisions about what level and type of cover members have. To consider this in detail, those members with death, TPD and Income Protection cover are at greater risk of being impacted by this policy as opposed to a member who only has death cover. This would place additional constraints upon the trustees which might force them to prioritise one type of insurance as opposed to another.

The problem is also likely to be more pronounced for older employees and those working in higher risk occupations, where the premiums will naturally be significantly higher. This will mean that trustees will be forced to make tough decisions with respect to the insurance arrangements for these particular groups of employees.

Members must have the option to retain their existing level of insurance if this is their choice. If a member has given consideration to their insurance needs and decided that they need a higher level of cover than would be permitted under the proposed premium limits, then they should have the ability to make this decision. It is not reasonable for the trustees to override a decision that a member makes about what might be the more suitable level of insurance cover. This is more important than whether they remain an Automatic Insurance member.

Cancellation and Cessation of Cover

10. What are your views on the proposed cessation and reinstatement mechanisms?

The AFA supports the guidance on the mechanisms for cancellation of insurance by the member. At present it is often too difficult for people to cancel insurance cover that they don't require and this often leads to duplicate insurance arrangements. For young people who often have multiple jobs and multiple superannuation accounts, the requirement to submit signed and witnessed forms may mean that they take no action. Their superannuation arrangements are often not high on their list of priorities.

The AFA is very concerned about the trustee initiated cancellation mechanism. As stated above, it is not uncommon for a financial adviser to recommend to a client that they hold their existing insurance arrangement within one of their current funds. This might be as a result of the fact that their health has deteriorated and that they might be unable to get cover in an alternative fund. Thus, the retention of this insurance may be particularly critical to them.

In the event that they had moved house and had not updated their address, they would not receive the communication from the trustee with respect to the likely cancellation of their insurance. There might be a range of other reasons why they do not see the letters.

We also question what the contractual basis is for the trustee to cancel the policy. Is there a contractual right or a regulatory right that enables the trustee to do this?

We note the reinstatement provisions, however this is limited to a 60 day timeframe, and in many cases this may not be sufficient, particularly if someone has moved house or is away or is confronting other issues in life.

We recommend that any cancellation mechanism is reliant upon positive confirmation by the member of their agreement to the cancellation of the insurance. Trustees should have the ability to communicate by mail, email, text message and by phone in order to make contact with the member to get this positive confirmation. The impending risk of the cancellation of insurance should be clearly explained in an annual statement well before any action is taken. This statement is often the source of truth to a member.

Duplicate Insurance Cover

11. What are your views on the proposed cessation and reinstatement mechanisms?

Whilst the duplicate insurance measure is recognised as one intended to assist members to avoid paying for unnecessary insurance, it is also potentially a means to authorise trustees to seek out information that they might use to endeavour to consolidate the member's superannuation accounts. This is potentially exposing the member to conduct that may not be in their best interests.

It is our view that such a provision, should also come with clear commitments about how this information is going to be used.

Thought should also be given to standardised terms and conditions. At present Total and Permanent Disablement cover definitions vary significantly. As an example, some funds will not cover you if you are in a work from home arrangement, while others will. How does the member know they are giving up cover that may be better than other cover they might choose to keep?

Helping Members to Make Informed Decisions

12. Which parts of the Code require particular attention for consumer testing?

We question the Heading for this section with respect to helping members make informed decisions. The actions in this section appear to be more focussed upon improved communication and information. There is a very big difference between this and helping members to make informed decisions. Once again, we come back to the importance of advice for members to make informed decisions.

In terms of consumer testing, we suggest that research is required on the following:

- An assessment of the level of understanding of the type and level of insurance that members have.
- An assessment of the understanding of types of insurance and what is covers.
- An investigation of the level of appreciation of the need for insurance.

13. How could the Key Facts Sheet template better assist members to understand and compare their cover?

Whilst we are broadly supportive of a Key Fact Sheet, once again we make the point that this fails to mention or encourage seeing a financial adviser to get financial advice on their insurance needs.

There is room for confusion with the question about “Is cover provided if a claim has previously been paid under another superannuation fund?” with respect to duplicate cover. Some members might conclude that this means that they can claim income protection benefits on multiple policies at the same time. This should be clarified.

14. Do the communication requirements in the code achieve the right balance between prescription and trustee flexibility?

The communication requirements set out in the draft Code are both comprehensive and prescriptive. The requirements are broad, in stating what trustees must do, without dictating exactly how they should be done. The AFA is supportive of such communication requirements, however noting that these requirements are likely to add materially to the cost of running a superannuation fund.

15. What further steps could be taken to engage members who are making no contribution or low or infrequent contributions?

The Code has introduced significant additional requirements for trustees in communicating with members who are making no contributions or low or infrequent contributions. There are provisions in the Code for contact with members through either their chosen communication method or multiple methods at the point that the trustees are seeking to cancel the cover. In our view it is still the case that we would prefer to see a positive confirmation response from members before the cover is cancelled.

Claims Handling

16. What are the practical implications of the obligations that are placed on trustees? How can any practical difficulties be overcome in a way that improves members' experience of the claims process?

In the AFA's view the requirements for claims management are appropriate and should better ensure a good outcome for members of superannuation funds.

Despite evidence to the contrary, Australians have a perception that it is difficult to get a life insurance payout, even when they are confident that they have a strong case. In practice the payout rates are very high and there are only a limited number of high profile stories that tend to impact the overall image. This is as much the case in Group Super Insurance as it is with other elements of the market. It is important to be on the front foot in projecting the message about the fairness of the claims process.

We are also particularly conscious of the extent to which lawyers are increasingly getting involved in claims, even when the member has a very high prospect of success. This could result in the end benefit being significantly reduced with no improvement in the outcome for the member. We believe that trustees could do more to protect members from the loss of a significant proportion of their benefits, merely for appointing a lawyer to help fill out a claim form.

It is recognised that trustees need to work with the insurers to get the best outcome for members and this three party arrangement often complicates matters and can lead to delays and substandard communication.

We would also recommend that superannuation funds place a strong emphasis on working closely with financial advisers during the claims process. Financial advisers can add a lot of value in this process through supporting members and also in liaising with them to obtain the required information. We recommend that superannuation funds design their processes accordingly.

The requirements of the Code are likely to mean that superannuation funds need additional resources or at least redirect existing resources. It will no longer be possible to place a high reliance on the insurer to manage the process.

17. Will the requirement at section 6.28 of the Code to provide a person claiming with information about a decline (including all documents obtained during the assessment) and the ability to provide further information in all cases cause delays and/or cost to the claims process? If there are concerns with these requirements, can specific examples be provided of the difficulties these requirements cause?

It is important to note that the primary responsibility of the trustee is to act in the best interests of the members. Supporting them in the claims process is important and particularly where there might be a rejection by the insurer that is worthy of review.

In our view the information covered in Paragraph 6.28 is reasonable for a trustee to provide to the member as part of the process of supporting them in the claims process. We will leave it to other stakeholders to comment on the impact of this on the process and difficulties with compliance.

18. What are the implications of the requirements on trustees to oversee and review ongoing income protection payments?

Oversight of members on income protection payments is a reasonable expectation as it is in the best interests of all parties for the member to be able to go back to work. It might be the case that the trustees need to rely upon third parties to achieve this outcome. It will also be important to avoid unnecessary duplication of the work undertaken by the life insurer.

Where the provision of ongoing information or regular doctors appointments are required, then it will be important for the trustee to have ongoing oversight of the case.

Vulnerable Consumers

19. Does the Code require more prescription as to how trustees will support vulnerable consumers?

In our view the Code adequately addresses the support that will be provided to vulnerable consumers.

20. What more can be done to ensure that members who are granted release of funds for terminal illness do not lose their insurance cover?

Paragraph 7.12 adequately addressed the fact that members need to leave sufficient funds in their accounts in order to pay future premiums.

Premium Adjustments

21. Are the premium adjustment arrangements sufficiently transparent?

The arrangements for the treatment of any premium adjustments or profit share arrangements are transparent, with clarity that the money is to be held in a reserve and used to adjust future premiums for members. The proposal includes strong disclosure requirements that make the premium adjustment policy readily available, along with disclosing any transfers to or from the reserve.

We support these premium adjustment requirements and believe that any flow of funds from life insurers to the superannuation fund or the trustee should be fully disclosed to members, whether this is in the form of a premium adjustment, profit share or a commission of any form.

22. What further detail could the Code include?

As discussed above, we believe that the proposed requirements around premium adjustments are an appropriate solution to ensure that members have adequate visibility of these payments. We would recommend that this is extended to include any payments from the insurer to the superannuation fund or trustees other than insurance payments that flow directly to the benefit of members.

Promoting our Insurance Cover and Changes to Cover

23. What are the practical implications of the Code obligation for trustees??

The general discussion in paragraph 9.1 on the promotion of insurance is appropriate. We question the way paragraph 9.2 is worded in that financial advisers and dealer groups do not “promote” insurance benefits. Financial advisers provide financial advice that takes into consideration the client’s relevant circumstances and is delivered in the best interests of the client. We are concerned that this paragraph inaccurately represents the role of financial advisers and appears to imply that there is an agreement under which they promote particular superannuation funds and their insurance arrangements.

We ask that this paragraph is reviewed with a view to more accurately reflecting the role of financial advisers.

The section on changes to cover appears reasonable.

Refunds

24. What are the practical and administrative implications of the refund requirements provided?

We note with some concern that the section on Refunds is not specific with respect to which insurance products that this would apply to. In our view it is only income protection where there are limits on the payment of benefits when a member has multiple policies. Where the member has multiple death and TPD arrangements, then they should be capable of receiving payment for each policy.

The way that this is worded, seems to add an additional right to reject multiple payments. In our view the Code would not override what is in the policy terms and conditions, but note that the trustees can renegotiate the insurance terms and conditions on a regular basis. This is an area for concern and would suggest that if this is the vehicle to influence industry policy on the payment of multiple claims then this should be removed.

We further note that there is no clarity as to how this denial of claim and refund of premiums would work and which policy might pay out and which one might not. We believe that this adds uncertainty for members and needs to be addressed.

Whilst we welcome the provision about refunding premiums following a claim, we question whether this applies to the specific type of cover under which the claim was made or the premiums for all types of cover (i.e. death, TPD, income protection).

25. Are there any issues with the maximum time limits for the duration of refunds?

We note the stipulated maximum timeframe is six years. Subject to our concerns raised above, we are of the view that this timeframe is reasonable.

26. Question for Superannuation Funds

Staff and Independent Service Providers

27. Do the standards for training and monitoring staff require further detail?

The AFA supports the statements with respect to the education, training, monitoring and remuneration of staff. We believe that this is sensible and addresses concerns around inappropriate incentive schemes that have been highlighted recently.

28. What are the practical implications of requiring trustees to ensure Independent Service Providers comply with the Code?

The measures to effectively manage Independent Service Providers represent good practice and are appropriate in the context of the complex business structures that are often employed in the financial services and superannuation industries.

We note the use of the word "Independent", and question whether these requirements also apply to related parties to the trustee. In our view this should apply to related parties and this should be clearly set out in the code.

Enquiries and Complaints

29. Do the processes for making enquiries and making complaints require further detail?

We note the grounds for rejecting the provision of information in paragraph 13.5(c) and (d) and assume that this applies to the information that is referred to in paragraph 13.2 of the code. We see little grounds for the information referred to in paragraph 13.2 being withheld from members and suggest that this should be better explained. If the powers in paragraph 13.5(c) and (d) apply to information other than that addressed in paragraph 13.2 then this needs to be clarified.

The details provided on making complaints appears to be comprehensive and we have nothing further to add.

Governance, Enforcement and Sanctions

30. Is the governance framework appropriate, taking into account ASIC's requirements for approval of the Code, and the governance provided by existing financial services codes?

We note the creation of a Code Administrator and the fact that it is proposed that the code administrator will be set up as a committee rather than a legal entity. We question the basis for why this would be the most suitable outcome.

Paragraph 15.7 states that the Code Administrator will report significant breaches to the relevant regulator. We question this given the fact that the trustee will have obligations as the licence holder to report significant breaches to the regulator and the fact that the Code Administrator will not actually be a legal entity. It seems impractical for both the trustee and the Code Administrator to both report the same breach to the regulator.

We note that the Insurance in Super Code Owners group does not include all the bodies involved in the ISWG and question why this is the case.

We do not believe that we have sufficient context around the governance design to comment further.

Conclusion

The AFA is broadly supportive of the idea of preparing a Code of Practice for insurance inside superannuation, however we have a number of concerns with the current draft. Principally we believe that the code fails to recognise the important role that financial advisers play in advising superannuation fund members on the most appropriate level of insurance cover. We are also very concerned about trustees making unilateral decisions about the most appropriate level of insurance cover or alternatively cancelling insurance, which may have a significantly detrimental impact upon members.

If you require clarification of anything in this submission, then please contact us on (02) 9267 4003.

Yours sincerely,

Phil Anderson
General Manager Policy and Professionalism
Association of Financial Advisers Ltd