

27 October 2017

Project Management Office
Insurance in Super Working Group
By email: ISWG-PMO@kpmg.com.au

Dear PMO,

Insurance in superannuation code of practice consultation

Thank you for the opportunity to provide a submission on the Consultation Paper, *Insurance in Superannuation Code of Practice (Code)*.

We support the intent of the Code to promote the purpose of superannuation, drive enhanced member communication and greater transparency, and to lift member engagement and improve member outcomes. We are concerned, however, with some technical aspects of the Code as it is currently drafted.

Within this submission, we make a range of recommendations to improve the Code. Our key points are:

- Trustee discretion is paramount and any decisions a trustee makes under their fiduciary duties to members that contrast with the requirements of the Code should not be regarded as a breach of the Code.
- Premium caps should be explicitly restricted to Automatic Insurance Members, furthermore individual members should be able to elect to be exempted from the requirements.
- Industry should aspire to streamlining its approach to the development of Codes. In the longer term, on the assumption that the concerns in this submission can be overcome, combining the Code with the existing Life Insurance Code may generate efficiencies and economies of scale.
- Cessation of cover obligations should have a timeframe of no less than 13 months, and more preferably 16 months or longer.
- Moving to the Code will require a comprehensive review of the Insurance Strategy and redesign of benefits to ensure premium limits will not be breached. The complexity inherent in implementing these changes may be challenging to complete within the proposed two year time frame.

About Colonial First State

Established in 1988, Colonial First State provides investment, superannuation and retirement products to individuals and companies. Colonial First State holds the number one market share position for retirement incomes¹. We are also the

¹ Strategic Insight June 2017

third largest administrator of retail funds with \$122 billion Funds Under Administration².

Colonial First State sits within Commonwealth Bank's Wealth Management division, which is also a leading insurance and annuity provider through CommInsure, provider of financial advice through WM Advice, and asset management through Colonial First State Global Asset Management.

Trustee discretion is paramount

We believe there is value in a code providing guidelines and superannuation industry standards. Consistent with their fiduciary obligations, trustees would be obliged to consider such industry standards when making decisions and seeking to discharge their duties.

It should be acknowledged that trustees are prohibited under trust law from fettering their discretion and so they need to be in a position to consider individual proposals at the relevant time having regard to:

- the factors relevant to their affected members– both advantages and disadvantages;
- the overall impact on the whole membership;
- the provisions of the governing trust deed and relevant law; and
- industry practice (such as outlined in codes of practice).

Having regard to the above matters, trustees must then determine whether various proposals they are considering are in the best interests of members. The Code's current form would make it difficult, if not impossible, for trustees to adopt it having regard to their obligations under trust law as described above. It is also unclear how this Code would interact with other legislative requirements (including the Superannuation Prudential Standards). For example, s68AA of the SIS Act requires MySuper funds to provide minimum insurance cover for all members. ASIC's Regulatory Guide 183 also states that Codes should reflect or enhance existing legislation.

We don't believe trustees can be bound by the Code without legislative intervention, or a significant carve-out, given the effect of the Code is the trustees would "pre-commit" to the matters in the Code without the above specific assessment (which needs to be made each time an insurance proposal is made by management to the trustee board).

Trustees also must ensure that they comply with the terms of the relevant trust deeds for their funds.

In our view there needs to be specific recognition that trustees, consistent with their duties under the SIS Act and in trust law, can depart from the terms of the Code when it is in the best interests of their members to do so, or where their trust deed requires otherwise. This should not be considered a breach of the Code.

² Ibid.

Premium caps

Rather than prescribing how insurance offering should be designed, the Code should provide guidelines for trustees to consider. Prescription leaves little room to address changing needs, different cohorts of members and runs contrary to the trust law prohibition on fettering discretions. This could include a requirement to consider the matters currently listed in paragraph 4.4 of the Code.

To the extent that a mechanism is required to prevent inappropriate erosion of member balances, our preference is for industry guidance that is industry regulated as opposed to legislative change. A mechanism such as a premium cap should be explicitly restricted to Automatic Insurance Members. Where an individual has indicated to their fund that they wish to retain a specific level of cover, they should not be restricted by premium caps or be subject to cessation of cover.

Trustee discretion is paramount, especially in situations where the trustee is aware of an individual member, or cohort of members', relevant circumstances.

Example:

Mary Jones has a self-managed superannuation fund which receives her superannuation guarantee contributions. She retains her previous superannuation fund to maintain insurance that she would not otherwise be able to acquire.

This is one example of a legitimate strategy that the trustee should be able to flag against the member's account. The member may still fall under the definition of an Automatic Insurance Member but has actually made a choice to retain existing levels of cover.

The trustee should be able to decide the methodology it applies to determine average individual earnings including the ability to base it on data relevant to an individual or for multiple cohorts within the same fund.

It should be recognised that superannuation funds may be unable to provide all three Life, TPD and Salary Continuance insurance options to individuals whilst remaining under the 1% premium cap. If all three insurances were able to be provided to individuals whilst remaining within the 1% premium cap, the cover may be of a lesser quality than its today equivalent.

Members under 25 also benefit from group insurance:

From 2012 – 2016, Colonial First State superannuation funds have paid the following insurance benefits to members under the age of 25:

- \$7.9m death benefits on behalf of 64 members
- \$1.5m to 10 members who have experienced total and permanent disability.
- \$3,000 per month (on average) to 40 members as an income protection benefit

Each of these claims has likely saved members or their beneficiaries from having to turn to the Government for social security support.

In the context of this discussion, and the final formulation of this element of the Code, it is worth considering the impacts to the overall levels of insurance cover in Australia.

Reforms requiring a minimum of death and total and permanent disability insurance cover within superannuation on an “opt-out” basis have gone some way to address the under-insurance problem in Australia. However, compared with other developed countries, the level in Australia continues to be lower (life insurance premium as a proportion of GDP is 1.5 times smaller than in Sweden, and two times smaller than in Japan³).

Code governance

It is not clear who would appoint the Code administrator and how independence is defined.

In the longer term, assuming the concerns in this submission can be addressed, combining the Code with the existing Life Insurance Code may generate efficiencies and economies of scale. The remit of the Life Code Compliance Committee, within the Financial Ombudsman Service, soon to be replaced by the Australian Financial Complaints Authority, should be expanded to cover governance of the combined code.

As discussed above, superannuation trustees are required to operate within the confines of trust law (fiduciary duties), and prudential obligations which may naturally conflict at times with Code requirements.

The manner in which breaches are proposed to be dealt with is also problematic. We have significant concerns related to protections of privacy, confidentiality and legal professional privilege. We do not consider it appropriate for non-remedied breaches to be reported to the Code owners given they include various competing industry bodies.

In addition, regulators only have jurisdiction over regulatory and prudential matters. Therefore it appears to be inappropriate to report non-compliance with the Code to them.

Cessation of cover and auto reinstatement

We support a minimum timeframe of 13 months to reduce the likelihood of member detriment. It is not unusual for individuals to take 12 month leave of absences from the workforce (e.g. for maternity leave or other career breaks).

In reality, where an individual takes 12 months leave from work, contributions may not be received by the fund until four months after the individual recommences work given superannuation guarantee is generally paid 28 days after each quarter. A minimum timeframe of 16 months may be more reasonable.

The trustee should have discretion on whether or not to cease cover based on their understanding of an individual member’s circumstances or more broad patterns of behaviour across the membership.

³ PwC, ‘Future of life insurance in Australia’, 2017

The timeframes for auto-reinstatement should commence after successful contact with the member (within a reasonable period of time). It should be recognised, however, that reinstatement is a matter for the insurer and, accordingly, the best trustees can do is to endeavour to build the desired reinstatements into future benefit designs paragraphs.

Automatic Insurance Members

The definition for Automatic Insurance Members would be more practical if worded as:

"Automatic Insurance Member means you are a superannuation fund member whose insurance commenced under an automatic acceptance arrangement when you joined the fund. You are not regarded as an Automatic Insurance Member if:

- a) you have told us that you want to maintain the automatic cover provided (which we must record) even after cessation of contributions;
- b) you make an application for cover (including cover that is underwritten or the recommencement of previous cover);
- c) you vary the cover in any way, such as cancelling, fixing cover or changing the benefit or waiting period;
- d) your insurance premiums are directly or indirectly wholly paid for by your employer or not paid by deduction from your account; or
- e) you are a defined benefit member."

The previous definition was too limiting in that it didn't appear to bring into scope MySuper products that generally do not offer default cover on an automatic acceptance limit basis, which are generally reserved for customised employer sponsored group arrangements or public sector plans. The insertion of subclause a) is intended to cater for individuals who engage with the fund to specify a desire to retain automatic cover.

Furthermore, we find the inclusion of a sub-clause exempting individuals whose premiums are directly or indirectly paid for by their employer to be problematic given the trustee may not always be aware of these arrangements. These arrangements may also change over time. We submit that trustee discretion may mean the trustee may or may not choose to apply the exception and this should not be considered a breach of the Code.

Cost to members

It would not be possible for a fund or life insurer to accurately calculate the impact of resetting group insurance without an extensive assessment. Insurers have indicated that the Code could easily lead to unintended consequences such as an overall increase in premium rates across the entire industry.

Auto-reinstatement is also likely to increase the costs of premiums as those members with poor risks are more likely to take up offers of re-instatement.

Initial and ongoing compliance with the Code and industry funding of a governance framework will also increase costs to funds.

Automatic insurance and younger members

KPMG's *Review of default group insurance in superannuation* report found that removing default cover for members under the age of 30 is not a particularly effective strategy for protecting retirement savings of low income earners. Furthermore, the likely impact to remaining members would be an increase in premiums by between 5 – 15%.

Aside from being an ineffective strategy, this course of action is likely to have the perverse impact of reducing the quality of group insurance as insurers and trustees attempt to maintain cover for the remaining members without inappropriately eroding retirement benefits.

Review of claims

As the industry has grown, the need to delegate functions has increased. Whilst trustees can delegate various functions, they cannot delegate responsibility. Thus, consistent with trust law, trustees cannot abrogate their responsibilities, and must monitor and supervise their delegates.

However, that does not mean that they must or should review every claim. It should be sufficient to review declined claims in detail, monitor acceptance of claims, review trends, investigate anomalies and perhaps conduct ad hoc audits of individual accepted claims.

Legacy products

Non-MySuper legacy products should be excluded from mandatory compliance with the Code given:

- the design of these offers may vary significantly according to the regime the products were modelled under;
- they may be administered on legacy computer systems;
- the value of the review and update of benefits for these members may not be commensurate with the costs involved.

Transition period

To the extent that trustees can introduce a cancellation provision for existing members and it is considered in the best interests of members to do so, no action should be taken to cancel an individual's cover until 2020 to ensure no members are impacted without funds being provided with enough time to take all reasonable efforts to update member contact details and make them aware of the potential cancellation.

Given the existing scale of default group insurance arrangements in place, it may not be practical for the industry to consider resetting all such arrangements within the proposed two year timeframe from Code adoption. It necessarily involves the co-ordination of multiple competing stakeholders, including trustee boards, life insurers, employers, specialist adviser and the members themselves.

Moreover, it would be very difficult for a fund or indeed group life insurer to accurately articulate what is involved to operationalise the Code without an extensive impact assessment.

A review of Colonial First State's FirstChoice Employer and Essential Super products found 51% of all Automatic Insurance Members may potentially lose their insurance cover under the proposed cessation of cover obligations or see their cover reduced to comply with the proposed premium caps.

A reasonable transition period is required to ensure members are fully aware of the impact to their existing cover and to be able to either make an election to the fund to retain cover and/or make alternative arrangements to prevent against unintended and potentially irreversible negative outcomes.

We welcome the opportunity to discuss these issues in more detail with the Working Group.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'L Elkins', written in a cursive style.

Linda Elkins
Executive General Manager
Colonial First State