Insurance in Superannuation Code

SuperRatings' Submission

October 2017

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1. Executive Summary

SuperRatings would like to thank members of the Insurance in Superannuation Working Group (ISWG) for providing us with the opportunity to deliver this submission in response to the Insurance in Superannuation Code of Practice consultation paper ("the Paper"), which contains the draft Insurance in Superannuation Code of Practice ("the Code") released on 20 September 2017.

SuperRatings is an independent research house, which has been assessing and rating superannuation funds for more than 15 years. Given SuperRatings background in superannuation, we are well placed to provide input into the development of the Code.

Overall, SuperRatings is pleased to see the steps taken by the ISWG in determining the draft Code and we welcome the raft of improvements that will ensue in relation to insurance within superannuation. We believe the Code will improve accountability across the industry, enhance the consistency of service provision and create more informed members, ultimately improving member outcomes.

In this submission, we respond to selected consultation questions which we feel we are best placed to comment on and which we think require further attention prior to the release of the final version of the Code.

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Once again, SuperRatings would like to thank the ISWG for the opportunity to prepare a submission to the draft Code and we would be happy to discuss any aspect of this submission further, as required.

Feel free to contact any of the following SuperRatings team members should you have any questions or require further information:

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2. About SuperRatings

SuperRatings is an independently owned superannuation research company providing data analysis, information, consulting services and product benchmarking to the superannuation industry, corporate sector and the general public. SuperRatings prides itself on providing impartial advice to funds and employers, therefore our ratings methodology includes all superannuation funds and we limit the ratings percentile bands of funds to ensure our assessment remains independent. We actively promote engagement, education and ownership of superannuation through the provision of:

- Research analysis;
- Ratings;
- Consultancy services;
- Product reviews;
- Benchmarking; and
- Opinion.

Since its inception, SuperRatings has comprehensively reviewed hundreds of Australia's largest superannuation funds and service providers. SuperRatings currently maintains detailed information in respect of 622 superannuation products, incorporating 105 MySuper products, 329 choice products and 188 pension products as well as 70,000 insurance product lines of premiums which are all housed within our in-house proprietary database, SMART.

We believe we offer the most extensive industry coverage accounting for over $1.38 trillion in funds under management and over 23 million member accounts. This allows us to understand the various costs, fees, products, services and performance of superannuation funds and benchmark these against the broader market.

3. Responses to Select Consultation Questions

B.2 Appropriate and Affordable Cover - Premium Limits

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

Maximum premium levels should be set to prevent inappropriate balance erosion and ensure affordability for a given member as well as a reasonable level of cover. As discussed in the ISWG's first working paper on balance erosion, affordability can be determined using several different approaches. We summarise these in the table below and discuss the main pros and cons.

Insurance Affordability Measures

Affordability Approach	Pros	Cons
1. Employer Contributions	• Indicative of earnings for a full-time worker with regular contributions.	• Not representative for a part-time or casual employee with irregular contributions, multiple employers and earnings which may not always exceed the $450 threshold.
2. Salary or Average Weekly Earnings	• Relates the premium payment directly to income.	• It is difficult to obtain up to date earnings data and estimates will be relied upon in most cases.
3. Account Balance	• Trustees have access to this data.	• Members could have multiple accounts e.g. they may have a low balance in one account but may keep it open to benefit from the insurance cover provided.
4. Projected Account Balance at Retirement	• Indicative of insurance impact over time.	• Determining the appropriate assumptions to use can be challenging.
5. Straight Dollar Limit	• Simple and easy to implement.	• Inflexible and given the wide variation in member characteristics it would be difficult to determine a suitable value if different values were used for the broad segments – younger members / bulk of the membership.

An additional affordability measure which has merit is a Net Cash Flow (NCF) approach which takes into account contributions as well as investment earnings estimated as a proportion of the account balance (e.g. a return of CPI + 3.5% p.a.) and outflows. In this case, ensuring that the total insurance premium cost does not exceed a set percentage of the NCF rather than considering a limit which is just based on salary or account balance provides a more complete assessment of the premium impact and a degree of flexibility. Specifically, it enables higher premiums at older ages, when a significant account balance has been accumulated, yet imposes a lower premium threshold on members with low contributions and balances.

The draft Code has selected limits based on option two; however, it has traditionally been difficult for Trustees to source earnings data, and we envisage that the premium limits based on Ordinary Time Earnings (1% for general members and 0.5% for members under 25) will therefore be challenging to implement. Particularly, for members who are no longer working and therefore not receiving a salary; however, they may have a reasonable account balance from which it is appropriate to deduct insurance premiums.

The Code suggests one approach is for Trustees to segment their membership to determine a suitable approach for different groups of members. SuperRatings is supportive of such an approach due to the complexity of monitoring compliance at the individual member level.

In practice, the limits will likely be based on broad averages across segments e.g. by age and income at the time of joining the fund. It is a delicate trade-off between functionality and accuracy, with this initial income a stale measure for members who have longevity of membership. We discuss alternative approaches to determine earnings in the next section.

Ultimately, the purpose of the premium limits is to ensure premiums are affordable and do not inappropriately erode members' retirement balances. Therefore, we believe a more appropriate approach is to consider premium limits based on projected retirement balances as per option four in Table 1. For example, ensuring that the total insurance premium cost does not exceed 5 – 7% of the projected retirement balance.

We acknowledge that this can be complicated to implement and difficult to explain to members; however, a hybrid approach could be adopted whereby Trustees determine a simpler set of limits based on analysis of the impact on projected retirement benefits. For example, the final limits could be "the lesser of x% of average contributions over the last 12 months and y% of current account balance", where x and y have been determined by the Trustee on the basis of modelling projected retirement benefits. We believe that further consideration of such methods is warranted to ensure that member outcomes remain at the forefront of the premium limit determination.

Evidently, there are a number of approaches and combinations of approaches which can be used to determine suitable and affordable premiums for members. Given the variation in approaches and the resulting outcomes we believe Trustees should be allowed sufficient flexibility in determining the method which is suitable for their membership in light of the resources they have at hand to undertake the required analysis (e.g. small funds may not have the capabilities to undertake complex and data intensive modelling).

It is also important that funds have robust processes in place to ensure that members understand the existence of the premium limits and are made aware of their impending breach of a limit and are given the opportunity to continue with the cover if they wish to do so, prior to cessation of the policy.

Funds will need to determine how to contact members in this regard initially, and over time to advise of an impending limit breach, for example via an email or phone call and systems will need to be created to trigger these communications. We believe the Code requires further guidance around these mechanisms.

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

There are a number of different approaches which could be used to determine earnings levels, subject to availability and privacy limitations, these include:

A. Income upon joining the fund
B. Australian Tax Office (ATO) income data
C. Estimates based on demographic data for example Australian Bureau of Statistics (ABS) data
D. Extrapolating Superannuation Guarantee (SG) contributions
E. Estimates based on salary data from recruitment firms e.g. Hudson Salary Guide by Industry

Considering the range of earnings estimates that could be used, the 1% limit is relatively arbitrary in the sense that the proportion of earnings calculated will depend on the value and the data source. Each of the above methods has limitations and if alternative methods are used across funds with membership bases which are similar, then this will cause inconsistencies. We believe the approach used should be standardised, where possible, and welcome the ISWG's proposal to include direction around earnings levels in the Code's Good Practice Guidance.

In relation to option A, improving the flow of data is important and expansion of existing infrastructure would allow funds to use the most up to date income based on starting income upon joining *any* fund. For example, the ATO's SuperMatch2 system contains information on new accounts communicated via the SuperTICK service – new accounts would provide the most up to date information regarding a member's earnings based on their starting salary at a new employer. Therefore, expanding the SuperTICK/SuperMatch2 system to allow funds to access the starting salary for a member's most recently opened account would improve the accuracy of information used to determine the premium limits.

Option B involves the use of ATO income data, which is tenuous due to privacy limitations and the distortions in taxable income that occur due to alternative income sources and deductions. Earnings estimates may vary both within the categories mentioned above and across categories, for example whether demographic data, as per option C, is segmented by age and gender or by age and worker type. The extrapolation of SG contributions can also be problematic as it may not be representative of a member's total earnings e.g. due to multiple accounts, multiple employers and irregular contributions. Furthermore, even if granular data sources were available specifying salary estimates for a given role, age, gender, state etc. it will be difficult for Trustees to determine which members to apply this information to as they do not typically have up to date information on a member's role and industry.

Moreover, given the irregularity of earnings for many young members who often enter the workforce on a casual or part time basis, SuperRatings envisages that the use of a 0.5% limit will again be challenging to reconcile in practice. In this case, starting income is likely to be particularly misleading, especially for younger members who may work for two or more employers and especially as younger members embark on potentially more stable full-time roles as they approach their mid-20's.

Given these issues and the significant variation in the characteristics of members across funds it is important that Trustees have adequate flexibility to determine the level of earnings which is suitable to their unique membership bases. Additionally, the Code's monitoring body should oversee the earnings level determination and ensure that similar data and methods are being used for comparable member segments across funds.

Question 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?

Premium limits could potentially result in lower levels of cover as funds seek to ensure premiums remain within the parameters proposed without increasing costs. It is important that members do not end up with inappropriately low levels of insurance cover, particularly for those members who are in the middle age group (say ages 40 to 55) who will generally need the highest level of protection from an insurance perspective as the levels of liability are highest at these ages. Further, the lower limit for younger members could potentially result in higher premiums for the remaining bulk of the membership.

The ISWG highlights in the Paper that determinations are yet to be finalised in terms of communicating to members regarding reduced cover levels and whether members who wish to retain their existing level of default cover would still be classified as 'Automatic Insurance Members'. A related issue is how to deal with members who would breach the proposed limits but wish to retain the cover and/or need to pay higher premiums following the change in benefit design.

SuperRatings would like to see some guidance around acceptable benefit design changes to ensure that members do not end up with inferior cover following implementation of the Code. For example, restricting the proportional increase in the dollar premium to say 5-10% of the original cost to retain the same level of cover and requiring cover levels to be reduced within a specified range.

In addition, SuperRatings suggests funds carefully consider the competitiveness of its default cover in terms of the level and dollar premium and how changes in benefits design will impact its membership.

B.2 Appropriate and Affordable Cover - Cancellation and Cessation of Cover

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

The Code proposes that cover should cease if no eligible contributions are received for 13 months (unless the member confirms continuation).

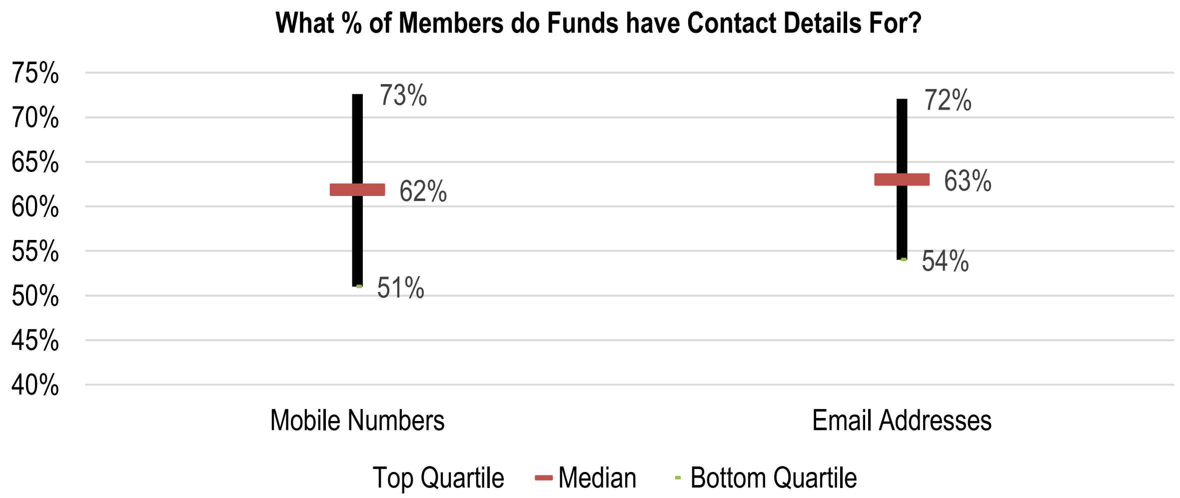
SuperRatings believes this is a two-pronged issue, firstly it is important that premiums are not being deducted from inactive accounts and inappropriately eroding the account balance. An account may be deemed inactive if a member has changed employers and has been assigned a new fund or if they are no longer working and thus not receiving contributions. In either case, they may have forgotten about the account and/or they may not be aware that they are being charged for insurance within it.

Secondly, it is also important that accounts which appear inactive, but are not necessarily, are not unduly cancelled, which could occur for a range of reasons. Although SG contributions are made by employers on a quarterly basis there can be payment delays, as well as a lag in implementation and processing of these payments, a member may also take extended parental leave or long service leave.

Thus, shortening the timeframe to say 6 or 7 months may result in cover being cancelled for members who are currently working or who are temporarily not working but still under employ.

Relatedly, communication with the member by writing and at least twice based on their preferred communication method prior to cancellation of cover is proposed and in theory this would permit use of a shorter timeframe. However, this process is complicated by the fact that there are high levels of disengagement among members and inadequate contact information for many members.

Although, SuperRatings found that data quality has improved across the industry in recent years, significant gaps remain with the median fund having mobile numbers and email addresses for about 60% of members, as demonstrated in the chart below.



The cancellation of cover can have drastic consequences and the processes around this need to be clearly and thoughtfully determined. Consider the scenario in which a member retains superannuation accounts with fund(s) that are not receiving their current contributions to potentially benefit from the insurance policy contained therein. Furthermore, by cancelling a member's cover Trustees could potentially expose itself to a liability due to legal action if for example, the cancellation was not implemented on a reasonable basis or the member was not adequately communicated with regarding the cancellation.

Given the aforementioned issues, SuperRatings believes that the 13-month timeframe is appropriate and that cover should only be cancelled for members aged between 25 - 55 years if no contributions are received and the fund is able to make contact with the member and confirm that cover should be cancelled. Whilst for younger members and those approaching retirement cancellation of cover if no contributions are received for 13 months and contact is attempted – twice based on the Code's proposal – but not made is appropriate.

In relation to the reinstatement of cover mechanism, which is proposed to be 60 days we believe that this should be determined at the time of contract negotiation between the trustee and the insurer.

B.3 Helping Members to Make Informed Decisions

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

In order to engage with members, funds need to have up to date contact information. Therefore, the first step is for funds to improve the overall level of data quality across its membership. SuperRatings has seen a number of funds excel in this regard through the use of specific data cleansing projects and initiatives, as well as working with external data providers to verify the accuracy of the information held.

We acknowledge that not all funds have the resources to undertake such programs; however, providing the functionality for members to update their contact details whenever communication is made is a step in the right direction, for example:

- In email communications, e.g. newsletters or annual statements, providing a link to update personal details.
- In writing, providing a postage paid return envelope with a form to update their details or instructions regarding how to do so online.
- If a member calls the contact centre for any reason, then the call recipient should always prompt the member to update any relevant personal or contact details and do so over the phone if applicable.

Additionally, engagement strategies via outbound calls and invitations to member education seminars or one on one workplace advice sessions prompted when a member reaches a key milestone e.g. turning 40 or reaching preservation age, can maximise member engagement.

B.6 Premium Adjustments

Question 21. Are the premium adjustment arrangements sufficiently transparent?

Historically, there has been a limited flow of information in relation to premium adjustment arrangements and a degree of misinformation around the impacts of these arrangements. Thus, SuperRatings is pleased with the steps taken by the ISWG to enhance the transparency and disclosure of these arrangements.

SuperRatings considers the Code's proposal to include detail regarding premium adjustment arrangements on a fund's website, as well as in the annual report, Product Disclosure Statement (PDS) and relevant insurance documentation to be sufficiently transparent.

Question 22. What further detail could the Code include?

SuperRatings believes that the potential for inequity between current and future members and the distribution of the benefits need to be thoughtfully considered by funds and detail regarding how this is managed stated in the aforementioned documents.

SuperRatings also believes that it is important for funds disclose whether they are not using premium adjustment mechanisms (PAM), since the impact on members can sometimes be worse in this case, for example if there is a substantial spike in premiums at the end of a 3 year insurance agreement if the claims experience has been worse than expected.

Thus, we suggest that all funds should be required to make a statement regarding how they intend to manage the premiums associated with the default cover policy on their website, in the PDS, annual report and any relevant insurance documentation including specification whether PAM are used or not.