

Mr Jim Minto
Chair
Insurance in Superannuation Working Group

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

2 May 2017

Dear Mr Minto,

NOTE FROM ISWG-PMO: This is a redacted version of the AFA's submission. Certain parts of the submission relating to the second ISWG discussion paper on Claims Handling have been temporarily withheld from public release until the proposed future publication of all other submissions received on that discussion paper.

AFA Submission – Insurance in Superannuation Working Group First Two Discussion Papers: Erosion of Superannuation Balance Due to Insurance Premiums, and Claims Handling for Insurance Within Super

The Association of Financial Advisers Limited (AFA) has served the financial advice industry 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.

Summary of the AFA's position

The AFA's recommendations are further detailed below, but can be summarised as follows:

Erosion of Superannuation Balance Due to Insurance Premiums

1. Section 5 of the FSC Code ("When you buy insurance") to apply to as many insurance policies held within superannuation as it is possible to, subject to reasonable considerations such as the benefit of automatic acceptance terms for some policies;
2. The AFA does not support automatic cessation of insurance cover on the basis of low premiums or other thresholds such as inactive or low contributions. We continue to support the principle of opt-out;

3. Super members to be given the option to make an informed decision on how to address the erosion of their balances rather than be disenfranchised by a system that reduces the protection extended to super members, including by supporting members to obtain quality financial advice on their life changes or at the very least by requiring member acknowledgement of changes in automatic cover;
4. The AFA supports formalising the existing protocol establishing the priority of income protection claims and supports;
5. The AFA supports refunding premiums paid on IP policies where multiple policies are held, but the refund should not be offset against the claim because such a refund is not a form of income, but rather a lump sum return of past income foregone;
6. The AFA supports the Working Group participants and members taking steps to improve decision making by members of superannuation funds and greater interaction with other parts of the system (such as MyGov, MyTax, SuperMatch, and Single Touch Payroll);
7. Underwriting policies at the time the member joins a fund will provide the greatest improvement in member decision making in respect of their life insurance policies;
8. The AFA considers that if a homogenous or more consistent reporting system – especially between apparently similar model portfolios, for example the ‘Balanced’ or ‘High Growth’ models – were mandated, it would lead to improved efficiency within the superannuation system;
9. To improve member decision making would be to streamline the rules and obligations of funds on proving identity of third party authorities, such as by implementing an industry standard on how third party authorities are sought by trustees; and
10. Responsively acting in members’ best interests should underpin trustees’ actions with members – whether by communicating to members where a pattern of contributions is disrupted or alerting members early who have multiple policies of the same type.

Claims Handling for Insurance Within Super

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Background and preliminary comments in relation to both consultations

The AFA supports measures to improve the insurance experience of superannuation members and to protect their superannuation balances from unreasonable erosion due to insurance premiums. The AFA also supports the Working Group’s intention of bringing superannuation trustees and the policies held within superannuation within the operation of the Life Insurance Code of Practice. These steps are long overdue and welcome as a means to better protect Australian consumers and ensure consistent treatment.

Member disengagement is a core reason for the proposals

The AFA considers that the primary driving force underlying the issues highlighted by the Working Group in both discussion papers released to date ultimately reflect that superannuation members are regrettably disengaged from their superannuation and misinformed about the protection they can expect from policies held within their superannuation funds. This core issue of member disengagement is symptomatic of larger problems that the super trustees have not done enough to resolve over recent years. The following have all contributed to disengagement and the associated problem of eroding balances and distrust in trustee claims handling:

- Underwriting at time of claim instead of assessing eligibility for cover at the time the member joins the fund. Many members are not even aware that they are paying for insurance cover. If they were to be informed through an underwriting process when they join the fund, they are likely to be better engaged throughout;
- Failing to support their members making informed choices on their super and insurance needs by positioning financial advice fees to be without value to super members. This position has

remained despite substantial improvements to adviser professionalism over the years and has ignored the value that advice brings to people’s wellbeing;

- Inconsistent investment options and risk profile categories across funds has caused confusion and misunderstanding amongst members. The proportion of growth and defensive assets in the balanced option of one fund should be the same as the balanced options in other funds to allow for effective and efficient comparison;
- Infrequent and hard to understand super statements that do not clearly and prominently disclose insurance premiums and the trajectory of balance erosion due to premiums. The level of transparency that members and their advisers have about what trustees do with their funds needs to substantially increase to restore trust in the insurance within super sector; and
- Acting only on their minimum disclosure obligations by detailing all terms in a lengthy, hard to read PDS, rather than consumer-friendly disclosure documents or innovating with other forms of communication. To begin with, all profit sharing arrangements that trustees have with insurers and their associated companies should be clearly and prominently disclosed up front at the beginning of all PDSes to ensure that members know when the trustee has an incentive to not act in their interests at claim time.

All of these issues can be resolved by trustees in order to restore community trust in superannuation. The AFA considers that trustees’ obligation to act in the best interests of members should become the vehicle to drive innovation in all the above areas to improve the situation for all super members.

Insurers choosing to underwrite at time of claim needs to stop

The desire of insurers to “maintain the flexibility” of continuing to provide cover without underwriting is unacceptable given the consequences to consumers who may not be aware that they are not actually covered until they claim. We support the underwriting standards in section 5 of the FSC Code (“When you buy insurance”) applying to more policy holders – including to most policies held within super.

The AFA recognises that consumers benefit from automatic acceptance terms on certain policies held within superannuation. We accordingly recognise that underwriting at time of claim does not apply to all policies held within super. Nevertheless, underwriting at time of claim appears to have become the default for many superannuation trustees – and especially relied upon by trustees and insurers when a member elects to take out additional units of cover or adjust their cover any time after joining the fund – which disadvantages many consumers who think they are insured when they are not because they overlooked the duty of disclosure disclaimer at the time of exercising an option.

The AFA accordingly supports increasing the availability of underwriting at the time that members join a fund and become eligible for insurance under that fund. This is the ideal time to engage with members and build a ‘buy-in’ attitude to ensure that members are less likely to disregard the significance of their superannuation or default cover. Whilst we appreciate that this will create slightly more administration when members join a super fund, the effort involved to clarify whether cover will be extended to them is worth more to consumers than unfairly allowing them to mistakenly believe they are covered when they may not be.

The benefit for insurers and trustees is that assessing a member’s eligibility for cover when they join a super fund will also give the insurers an appreciation of the proportion of members who may not be covered by the policy terms, and this in turn should drive product innovation to tailor other or future upgrades of insurance policies to the needs of members. Offering a suite of policies that will actually

provide cover to super members should be attractive to trustees and therefore should be sought out. Not doing so and placing the onus on super members to ensure they are covered is not consistent with the spirit or the intention of section 68AA of the SIS Act that requires trustees to provide members with permanent incapacity and death benefit insurance.

Erosion of super balance discussion paper proposals

Automatic cover benefit and premiums

The AFA supports the FSC Code stipulating principles for designing automatic cover benefits that better reflect the needs of cohorts of superannuation members. At present, there is too much variability amongst superannuation fund policies and inherent assumptions that don't apply to many members. For example, default funds should have one standard definition for say TPD so members are not disadvantaged moving from one fund to another.

That being said, the AFA supports a better system for ensuring that members' segmented insurance needs are better reflected in the types, levels and breadth of cover available to members. Whilst we support automatic cover changing as a member ages, the AFA **recommends trustees be required to contact members to ensure they confirm they understand that the change will take place**. As will be discussed below, encouraging members to seek financial advice should not be avoided because of the current restrictions on how members can authorised payment for advice they receive, and as several trustees partnering with advice firms have recently shown, there are substantial benefits for all – especially members' wellbeing – if members can make better informed decisions about their superannuation assets and default cover.

Requiring member acknowledgement of changes in automatic cover (such as directing less premiums toward TPD cover as a person nears retirement) is a feedback loop that would better protect against member disengagement and ensure that members can make informed choices about their overall situation. Unreturned acknowledgements would indicate to trustees that a member may have moved residential address or not be accessing their stated email address. This would then place an onus on trustees to try other methods of engaging with the member and ensure, rather than assume, that disclosure of the change has been effectively communicated.

Further, coupling the acknowledgement with a mandated recommendation to seek financial advice will alert members to the significance of the change and give them opportunity to seek out complementary cover to their default cover. It is in the interests of the Australian public that information asymmetry is reduced and more Australians adjust to their life changes by being given opportunity to make better informed choices. Likewise, the AFA does not support automatically applying a newly designed cover to existing members unless the trustee can demonstrate that there will be a materially better benefit for the cost of the new cover. Existing members should be given the choice of moving from their existing cover to a newly designed form of automatic cover and if this notice is coupled with an acknowledgment and recommendation to seek advice on the choice, then the member can make a better informed decision.

Further, the AFA does not support giving trustees the option of performing an automatic cover assessment at lower levels than a minimum. It beggars belief that a system for designing minimum insurance levels to protect members could be opted out of by trustees "if they so desired". Such an option would enable trustees to place their own interests ahead of members' interests and allow trustees to game the system to

work around Code requirements. A Code should seek to improve practices and encourage best industry practice, rather than permit a race to the bottom.

The AFA also supports premium levels being better tailored to members' needs. However, setting prescribed maximum premium levels by reference to a single system across all trustees is fraught with danger that individual members will be disenfranchised without their knowledge. The key reason for erosion of super balances is disengagement of members who are not adequately educated by trustees on their superannuation and insurance options and who trustees do not actively engage with regularly. Whilst we support the intent to put safeguards in place to ensure that premiums do not inappropriately erode retirement options, setting maximum premium levels by algorithm is not the solution. Any safeguards should first prioritise member engagement, not give trustees greater ability to assume members' minds.

Automatic cessation of cover

As outlined above, the AFA does not support automatic cessation of insurance cover due to low premiums or other thresholds such as inactive or low contributions. We support the principle of opt-out because statutory insurance within super is a critically important benefit to consumers and subsidises the public system of protecting Australians.

Super members should have a right to choose whether their cover is turned off. To help them make those choices, super trustees can and should encourage members to seek financial advice. This can be facilitated in numerous ways, by referring members to a panel of advisers who can give the members advice on their options, by partnering with advice licensees to refer members to or by checking the member's account to refer the member to the financial adviser who established the account.

If a member chooses not to get advice or not to follow advice, that is their right to do so and a better outcome that automatically disenfranchising them without their consent. Informed choice and reducing information asymmetry are the principles to pursue, rather than taking choice away from members. This is also an important principle because it acts as a safeguard against super trustees' applying their obligation to act in members' best interests in a collective sense to the detriment of individual members' interests.

Where members choose not to seek advice or to act independently, members should be required to sign an acknowledgement of their choice as mortgagors do with home loans. If a member opts out of their cover, they should be offered recommencement of cover when SG contributions resume. This will be noticeable to the trustee and it is incumbent on the trustee under section 68AA of the *Superannuation (Industry) Supervision Act 1993* ('**the SIS Act**') to ensure cover is recommenced.

When cover is recommenced, it should be under the policy terms that were in force when the cover ceased, not under terms that have subsequently changed and be subject to medical underwriting at re-commencement.

Multiple income protection policies

The AFA supports formalising the existing informal protocol establishing the priority of income protection claims. The AFA understands this informal protocol has been in place for the better part of the past decade and was developed in response to determinations by the Financial Ombudsman Service's predecessor scheme the Financial Industry Complaints Service.

Trustees can act proactively to ensure that income protection insurance remains relevant for those members who hold their IP policies within super. Trustees make arrangements with employers to provide default funds. Through those arrangements, trustees can require employers to inform the trustee when an

employee/member ceases employment. The trustee can check whether that member holds income protection and then contact that person to ask whether they wish to retain the cover and recommend the member seek financial advice to help them make an informed decision. This employment termination notification obligation should also apply to employers notifying insurers under the terms of group insurance policies they extend to their employees.

Where the super fund is not a default fund, the trustee would know which members are advised because cover was placed or super was rolled over by an adviser on behalf of the member. Where the trustee notices lower than normal contributions or contributions ceasing and the member holds IP cover, they should contact the member (copying in any adviser they are aware of) to ask whether they wish to retain cover and recommend they seek advice. Where no adviser is noted against the member, the trustee should refer the member to a panel of advisers who can offer to provide advice.

The AFA supports formalising the current informal protocols around priority ranking of IP claims, including the principle that prioritises a later claim lodged that could provide the member with a better material benefit.

The AFA supports refunding premiums paid on IP policies that will not pay a member a benefit because another policy is subject to the member's claim. We support refunding the premiums back to the date of the overlap in policies beginning, as this is the amount of money the policyholder would have saved had they not held multiple policies.

As it is not a form of income, but rather a lump sum return of past income foregone, **offsetting a refund of premiums against the claimant's potential benefit under a paying policy would be inappropriate.** This is a refund of funds owed to them that the claimant would not have divested themselves of had they only had one policy with appropriate cover.

Improving member decision making

As outlined above, the AFA supports the Working Group participants and members taking steps to improve decision making by members of superannuation funds and aside from the proposal to improve data sharing amongst insurers and interaction with other parts of the system (such as MyGov, MyTax, SuperMatch, and Single Touch Payroll), the AFA has several recommendations to make in this respect.

Choosing not to underwrite at time of claim

Except where insurance is based on automatic acceptance terms, the AFA considers that **underwriting policies at the time the member joins a fund will provide the greatest improvement in member decision making in respect of their life insurance policies.** This can be as simple as assessing eligibility for cover at the time the member joins the fund. Many members are not even aware that they are paying for insurance cover but worse still, a member who believes they have cover is at greater risk potentially than one who knows they have no cover. If they were to be informed through an underwriting process when they join the fund, they are likely to be better engaged throughout.

The benefit of financial advice

We support consumer choice and we recognise that not everyone at every stage of their life is actively engaged with retirement goals. Nevertheless, of the channels through which consumers access their superannuation accounts and benefits, we believe that higher efficiency and quality results where the consumer is advised by an expert financial adviser – especially where the member has multiple super accounts. As noted above, **member decision making would be vastly improved if they were referred to a panel of advisers or to seek their own financial advice when they encounter an issue or a choice**

to be made about their cover within their super. Whilst there are current restrictions on how such an adviser may be remunerated, this may not always be the case and members can still agree to pay for such advice via fees for service. Several insurers and trustees have recently partnered with advice firms and we support this trend continuing.

Better statements improve financial literacy

Improvements can also be made to superannuation statements to improve members' decision making. The wellbeing gains delivered by better financial literacy and empowerment have a flow on effect to the public health system, the health of employees in the workplace including community benefits that result from a more confident and assured public. Accordingly, the AFA considers that **superannuation members would be better served and more efficiencies gained through clearer reporting from superannuation trustees.**

Many of our members report that the differences and inconsistencies between how super trustees currently report investment performances – especially amongst presumably similar model portfolios – leads to a higher cost to serve (that is, provide advice) to their client superannuation members. The AFA considers that if a homogenous or more consistent reporting system – especially between apparently similar model portfolios – were mandated, it would lead to improved efficiency within the superannuation system. This is because such a simple change would lead to more certainty amongst superannuation members and advisers but also lower costs of assessing valuations and performance.

The Working Group's proposals to improve data feeds and sharing of data could then facilitate better reporting. This should in turn result in a review of the APRA standards on member account reporting and improvements in the consistency of portfolio allocation terms to ensure that certain terms were not permitted to be used if assets allocation falls out of the acceptable ranges – thereby creating consistency of expectation amongst superannuation members and their authorised agents.

Third party authority processes

Another recommendation we would make **to improve member decision making would be to streamline the rules and obligations of funds on proving identity of third party authorities, such as by implementing an industry standard on how third party authorities are sought by trustees.** It is not clear to AFA members why every fund has its own version of privacy rules when the privacy obligations upon trustees under the Australian Privacy Principles are identical.

Trustees initiating better engagement upon discovering changes that affect members

Further, we **recommend that another improvement that could be made is to communicate to members where a pattern of contributions – such as SG contributions – is disrupted.** This would alert superannuation members to situations where arranged contributions cease or are suspended and thereby enable them to action the disruption to ensure that their retirement savings are maximised.

Likewise, **when super trustees become aware that a member has multiple policies of the same type, it should be incumbent upon them to inform the member of this and give them the opportunity to seek advice** on the effect of holding multiple policies. Alerting a member to a situation they may wish to think carefully about should not prevent trustees from acting in their members' best interests. Currently, the obligation to identify multiple accounts is only an annual obligation.

Whilst this is the minimum obligation, the Code could encourage trustees to perform this assessment more regularly or by establishing a protocol for trustees to communicate amongst each other to be more

responsive to members' needs. Accordingly, **the AFA supports the Working Group's proposal to establish protocols** to identify such situations.

In the AFA's view, all of the above changes are within the capacity of trustees to implement in a short period of time and would collectively change the experience of members and drive greater member engagement with their superannuation. This is the common aim of super trustees and financial advisers alike because the more engaged superannuation members are the higher their levels of financial literacy, well-being and desire to seek out advice. The AFA will support steps taken by trustees to better facilitate quality advice for more Australians.

Claims Handling discussion paper proposals

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Concluding remarks

The AFA agrees that trustees should use the recent focus on superannuation as an opportunity to improve its processes and deliver better outcomes and experiences for their members. Financial advisers are responding constructively and embracing changes to professional standards; modernising business models ; and taking leadership in other areas of financial services reform for the betterment of consumers. So too should trustees because nearly every Australian has a superannuation account and therefore nearly every Australian will potentially be better off from reform in this sector.

The AFA considers that member choice and respect for vulnerable members are the key underlying principles for trustees to build their re-developments around. Choice leads to informed decision making, which leads to increased financial literacy and greater wellbeing. Respect for the vulnerable is a core cultural objective for any company that deals with people in life-critical situations. To restore the social licence of insurance within superannuation, choice and respect for the vulnerable are the two pillars that these reforms, and any commitments in the Code, need to be built around.

Having said that, subsidiary but no less important principles for the Working Group to acknowledge are that engagement with members needs to substantially improve. Engagement with superannuation must be improved for the superannuation industry to position itself as a key sector underpinning retirement self-sufficiency. In the AFA's view, the goal should be active engagement, not engagement through an algorithm – which could be where the industry is headed if reasonable boundaries are not built around the proposals for automatic cessation of cover and re-commencement.

When you are trusting others to take care of your family, there is no substitute for an understanding person's voice on the other end of the line. Whether that be an industry-funded claims assistance officer, a claims assessor embedded within a trustee's offices, or a financial adviser you can expect independent advice about your options from. A human voice wins hands down over robots and hard to understand super statements every time. Financial services are hard for most to understand and superannuation is known for being a complex system.

The more that financial advisers can work with superannuation trustees to restore the social licence to insurance within superannuation, the better for all. We recommend these improvements and look forward to working with the Working Group to refine these issues as we work toward trustees becoming subject to the FSC Code of Practice in the near future.

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

Yours sincerely,

A handwritten signature in black ink, appearing to read 'P. Kewin', with a stylized, cursive script.

Philip Kewin
Chief Executive Officer
Association of Financial Advisers Ltd