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ACCOUNT BALANCE EROSION DUE TO INSURANCE PREMIUMS

Submission to the Insurance in Superannuation Working Group

ABOUT US

Set up by consumers for consumers, CHOICE is the consumer advocate that provides Australians with information and advice, free from commercial bias. By mobilising Australia's largest and loudest consumer movement, CHOICE fights to hold industry and government accountable and achieve real change on the issues that matter most.

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WWW.CHOICE.COM.AU **E** CAMPAIGNS@CHOICE.COM.AU
57 CARRINGTON ROAD MARRICKVILLE NSW 2204 **P** 02 9577 3333 **F** 02 9577 3377

THE AUSTRALIAN CONSUMERS' ASSOCIATION IS NOT-FOR-PROFIT COMPANY LIMITED BY GUARANTEE. ABN 72 000 281 925 ACN 000 281 925

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INTRODUCTION

CHOICE appreciates the opportunity to provide the following comments to the Insurance in Superannuation Working Group consultation on account balance erosion due to insurance premiums.

Consumers could see significant savings if insurance in superannuation was better targeted to their needs. Modelling from the Financial System Inquiry found that removing duplicate accounts could increase superannuation balances at retirement by around $25,000 and retirement incomes by up to $1,600 per year.[1] About two thirds of this cost or $16,000 was due to duplicate insurance. This is clearly not an efficient use of resources, with fund erosion due to fees ultimately contributing to an increased reliance on the aged pension.

Life insurance is a product that gives people comfort at some of the most challenging times in their lives. Given the default nature of life insurance in superannuation, this sector has a special responsibility and should be held to the highest standards. We are pleased to see this industry led approach begin to highlight and develop solutions to some of the key problems in this sector, beginning with account erosion.

Key recommendations:

- That an enforceable code be created with obligations on industry.
- That product design principles be created that matches member cohort needs.
- That a definition of 'inappropriate erosion' takes account of more than just the impact on final retirement balances. This metric needs to be balanced against the quality of the product and suitability in meeting a cohort of members' needs.

[1] Modelling prepared for the Financial System Inquiry using Treasury models, October 2014. Based on assumptions of 37 years of work with an average of 2.5 accounts over a person's working life, fixed fees of $80 per account and $140 for insurance per account per annum (in 2014 dollars)

Benefit design principles

Establish design principles to be adhered to when determining automatic cover and affordable premium levels.

1. Do you support the development of guidance on the determination of appropriate cover levels? If not, why not?
2. What should be the trade- off between prescription and flexibility in this guidance?

CHOICE supports the development of an enforceable code to help determine appropriate levels of default cover for fund members. It is vital that what is produced comes with obligations on industry. The creation of unenforceable guidelines is counterproductive and will not lead to meaningful change in product design.

One option to ensure adequate flexibility, while maintaining specific obligations, would be to structure a code to align with the proposals around design and distribution obligations (DaDO).[2] The Treasury paper on proposed DaDOs show's how issuer and distributor obligations could apply. For example, it calls for an obligation on issuers to:

- *identify appropriate target and non-target markets for their products;*
- *select distribution channels that are likely to result in products being marketed to the identified target market; and*
- *review arrangements with reasonable frequency to ensure arrangements continue to be appropriate.*

This broadly aligns with existing obligations on trustees to act with due care and skill and the duty to act in the best interests of beneficiaries. What is missing is a clear statement from industry as to what are appropriate product design features and a requirement on trustees to clearly state and make publicly available how their chosen designs align with this industry guidance. Such guidance would not only ensure a more close analysis, but could be used by consumers, consumer organisations and other third parties to assist decision making around the suitability of insurance for an individual consumer's needs.

[2] Australian Government, 2016, 'Design and Distribution Obligations and Product Intervention Power Proposals Paper', December 2016, available at: http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2016/Design-and-distribution-obligations-and-product-intervention-power

- Should the guidance be tailored to certain cohorts (particularly age)? What flexibility is needed to cater for different demographics e.g. members who have casual employment patterns?

New rules and associated guidance should be tailored to certain cohorts. The discussion paper correctly identifies, for example, that younger members are likely to need lower levels of death cover, but may require greater levels of disablement benefits. The discussion paper lists a number of factors that are likely to be important considerations in determining cohort needs.

Funds should be looking to make it easier for members to opt back in or re-commence cover if they have previously opted out. This could be done around key life stages when there are likely to be changes in a member's needs. For example, Government policy currently encourages consumers to consider their health insurance needs at age 31. This is an important age where consumers are more likely to have dependents and greater financial responsibilities. Offering consumers the ability to opt back in to insurance without underwriting at this age may provide enough of an incentive to encourage bulk sign-ups without adding too much risk to the pool and decreasing overall underinsurance.

Ultimately trustees should continue to be required develop a product based on the individual needs of their members. Guidance should be available to set a common set of understandings about insurance needs. This should ensure trustees are adequately accounts for the needs of key cohorts of consumers that are likely less well-served by current arrangements, such as:

- people on a casual work contract,
- people on a low income,
- people on a career break (e.g. parental leave),
- older people or
- younger people

If a trustee wishes to stray from these common precepts then it should provide evidence and justification for taking a different approach to design. Information on product suitability should be made publicly available in a consistent format to aide consumer comprehension.

3. What would be the consequences of just applying to new members as opposed to existing members?
4. What would be the impact in terms of cost for funds/insurers in using principle-based guidance?

Ultimately these principles of product design should apply to all members. Consumers have a reasonable expectation that they will be offered to well designed, appropriate products whether they are new or existing members. Some trustees may need to alter their products to better target the changing needs of members. This can reasonably be done in a staged process to maintain system stability.

5. If there was a focus on individual cohorts – are young and the older Australians the appropriate grouping?
6. Are the age bandings correct? Alternatively, should Young = < 21 and Older = > 60?
7. Are there any other considerations that should be called out?

As a general principle consumers should not be paying for insurance they cannot use or do not need. If a cohort of consumers is likely to fall in to either of these categories, then control mechanisms should be in place to prevent account erosion.

As well as young and older Australians, thought must also be given to more appropriate ways to meet the needs of parents taking time out from paid employment to have and raise children. For example, this change in circumstances may impact their eligibility under an Income Protection (IP) policy. Given the fact that these consumers may not have contributions flowing in to their account and the large impact the inclusion of IP has on insurance premiums, there is a case for more active member engagement and product design around this life stage to better match the needs of consumers.

HESTA has designed its insurance policy to mitigate this problem. It offers fee-free insurance cover whilst on parental leave for up to twelve months.[3] Trustees should be required to assess how their products are designed to meet the needs of people on parental leave.

The major reason for taking out a death insurance policy is to protect dependents. Given people are generally entering long-term relationships and having children later, there are now longer periods in a person's working life where they are without dependents, but continue to pay for significant levels of cover through their superannuation. For example, in 2013 the average age men (31.5) and women (29.5) got married was higher than in 1993, at 28.8 and 26.4 respectively.[4] As rates of marriage decrease this may be a less relevant measure of financial commitment, instead figures such as the average age of first home ownership, 37.7, may be more relevant.[5] By the time the average father (33) and mother (30.9) have children they have

[3] HESTA, 2016, 'Insurance options to protect you and your family', available at: https://www.hesta.com.au/content/dam/hesta/Documents/Insurance-options.pdf
[4] ABS, 2014, 'Marriages and divorces, Australia, 2013', ABS cat. no. 3310.0. Canberra: ABS.
[5] ING Direct 2015, as quoted in Daily Telegraph, 30/10/2015, available at: http://www.dailytelegraph.com.au/realestate/news/sydney-nsw/the-average-age-of-australians-buying-homes-has-shot-up-over-the-last-decade/news-story/f42862e70e61d7e27b244fa3b6ef48f4

likely been paying for a significant level of default death cover through their superannuation for several years.[6]

Given we are discussing a default system it is worthwhile considering the merits of this age setting through a utilitarian framework. A basic utilitarian guide is about maximising utility, or in context, the age at which the benefit of cover is likely to outweigh the cost of premiums for the majority of members. Where there is little utility, because the average member doesn't have dependents, then the cost cannot be justified. Using the average age parents first have children, this approach would likely lead to the age 30 being the right life stage for more significant levels of cover to apply. A more nuanced utilitarian approach may take in to account a qualitative consideration. For example, the benefit to an individual having increased cover from age 25 may outweigh the cost to the majority continuing to pay premiums until age 30, despite the potential for over-insurance. This more qualitative approach would potentially see the age 25 as a more appropriate age for cover to be increased. Ultimately there needs to be a more thorough analysis of the benefits of life insurance in superannuation and its impact on the retirement outcomes of consumers, balanced against the immediate benefits it may offer. We would expect this to become clearer once proposed industry research on the 'benefits of life insurance in superannuation' is released.

Funds are free to communicate to members about their changing needs throughout their lifecycle and sell suitable products accordingly. Improved customer engagement needs to complement whichever default settings are developed.

For older Australians the need for life insurance is likely to sharply decrease as they age. With decreased rates of household debt and close proximity to retirement age, older Australians are more likely to be in a position to rely on superannuation savings to substitute or supplement the age pension.

One consideration which is missing from this list is the impact of government benefits (e.g. disability pension), insurance held elsewhere (e.g. through another superannuation fund) and any other payment or income stream. A holistic approach would assess and make explicit what insurance is designed to cover as distinct from existing safety nets.

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[6] ABS, 2015, 'Births, Australia, 2014' available at: http://www.abs.gov.au/ausstats%5Cabs@.nsf/0/8668A9A0D4B0156CCA25792F0016186A?Opendocument

Maximum premium levels

Define 'inappropriately erode'.

8. Do you have a view as to what the definition should be or should reference?
9. What definition or interpretation are you currently employing in your fund(s)?
10. Are there specific cohorts of members that need to be considered in a definition? Why?

The issues paper proposes that a definition of 'inappropriately erode' could include:

- The anticipated cumulative impact on account balances at retirement
- Interaction with anticipated contribution levels and net investment

While these are important considerations, they do not necessarily give a framework for actually deciding 'what is inappropriate erosion?' These two factors must be combined with a needs analysis which could be used to balance fund erosion against coverage needs. For example, in some high risk cohorts a higher percentage of erosion may be justified to ensure sufficient benefits. This would also ensure that consumers were not simply given poor quality cover to keep premiums below an arbitrary 'inappropriate erosion threshold'.

Establish overarching prescribed maximum premium levels for automatic insurance coverage.

11. Should maximum thresholds be prescribed?
12. How frequently should the assessment of maximum thresholds by a fund be made? Annually?
13. Upon the expiry of premium guarantee periods? Every three years? Whenever prices or automatic insurance levels are changed?
14. Should there be one set of maximums or should they differ between different occupational age groups?

As already discussed, caution should be exercised in prescribing maximum premium levels without adequate reference to the needs of individual cohorts (e.g. people who are younger, older or on parental leave). It would be counterproductive if funds were able to keep within prescribed maximums to avoid scrutiny about whether their products adequately met the needs of members.

In the first instance, the needs of individual cohorts should form the appropriate anchor point for setting premiums. Subsequently it may be appropriate to use a maximum premium level filter to gauge the level of affordability.

These affordability overlays should be used during the product design phase. It is anticipated they will need to be reassessed whenever price movements occur to ensure ongoing affordability.

Where a cohort of members fall outside of these prescribed maximums this should be a strong indication to the fund that there is a need for member engagement, around individual needs as well as product redesign. Engagement at this stage may help identify members with changed needs due to factors such as changed working arrangements.

Ceasing and recommencing cover

Establish an industry standard for cessation of automatic cover due to low contributions, contributions inactivity or low account balances.

15. Should a Code prescribe cover cessation thresholds?
16. Do you have view as to what the thresholds should be?
17. Should there be one set of thresholds or should there be a small number allowing for different occupational / age groups?
18. What maximum period of inactivity is most suitable to commence communicating with inactive members – 3 months, 6 months or 12 months, other?

There is a significant benefit in developing a common cessation threshold which meets community expectations. There have been widely reported cases of cover cessation which have not met these standards and lead to consumer detriment; understandably funds have suffered damage to their reputation as a result.

The maximum period of inactivity which is suitable for communicating with inactive members is three months. This lines up with employer obligations to pay superannuation and is the earliest funds are likely to be aware of a change in a members circumstances. CHOICE research found that consumers are looking for a trusted partner when it comes to engaging with superannuation, however few consumers saw their fund as fulfilling this role.[7] This trust can be regained if funds take on a genuinely assistive approach to engagement.

Inactivity after three months is a key moment at which funds can helpfully provide information to a member. For example, it may be indicative of non-payment by an employer, changed or loss of employment. In each of these circumstances communicating with a member about their options can help them save money. Funds could provide information on:

- tracking down non-payment of superannuation,
- the cost of maintaining multiple accounts, or
- Steps they can take to assist retirement savings if they are taking time out of paid employment for events such as having children.

These types of harm prevention notifications have been used to good effect in the telecommunications sector, where consumers are given standard information (via text message) informing them of their usage data.[8] This prevents overspending and bill shock, similarly it could be used to prevent consumers from losing out on employer contributions or maintaining unwanted duplicate accounts. It could also be a trigger point for a conversation about the cessation of insurance cover.

These measures were so successful at rebuilding trust in the telecommunications sector that some providers began advertising usage notifications as a useful product feature to consumers. This is despite the fact that notifications were mandated by regulation.

19. Unless members have elected to retain their cover, should all policies include a mandatory cessation clause if there is an extended period of contribution inactivity? Why?
20. What maximum period of inactivity is most suitable to stop cover if they do not respond to earlier communication – 6 months, 12 months, 18 months or 2 years, other?
21. Should a mandatory cessation clause only apply to income protection cover, to mitigate against the impact of income offsets?

All policies and types of cover should include mandatory cessation clauses, because on balance they cause less consumer detriment than the alternative. The system as proposed gives adequate opportunity to consumers who wish to maintain their cover. Upfront disclosure,

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[7] Pollinate, 2016, 'Project Superpower – informing a strategy to engage people with their superannuation', Research commissioned by CHOICE, available at: https://www.choice.com.au/~/media/39a3a46234d64be398df0ebaba25c65d.ashx?la=en
[8] *Telecommunications Consumer Protections Code C628:2015 Incorporating Variation No.1/2016*

warning notifications and safeguards for members who have had their contributions inadvertently stopped should be sufficient protections so long as they are clear, consumer tested and sent at appropriate times.

Also, a major cause of contribution cessation is change of job and the creation of a second default fund; therefore it is less likely that those who have their cover automatically ceased will not have cover elsewhere.

The discussion paper acknowledges the need for a uniform timeframe for ending coverage where a member has not responded to communication. As an example it proposes a 90 day cut off and notes that losing coverage means the loss of valuable benefits, which is often only felt at the time of claim. Taking into account consumer behaviour, a 90 day cut off may be too long and actually lead to avoidance behaviour. A shorter timeframe of 30 days may prompt a more rapid response. Alternatively, easy processes for continuing cover and regular reminders could keep this decision front of mind.

The discussion paper acknowledges that the consumer detriment of multiple policies is lessened for death and disablement because there is an ability to claim against each policy. Despite a consumer's ability to make claims against multiple death and disablement policies, mandatory cessation clauses should apply to prevent account proliferation across all types of cover. The overriding principle should be that consumers are better off with a single well designed product, rather than having to rely on the unpredictable fortune of multiple policies.

22. What flexibility is needed to cater for different demographics e.g. members who have casual employment patterns?

The discussion paper proposes engaging members with 'low contribution activity' about insurance cessation. As already outlined, engaging members at times that will help them save money is a positive measure to rebuild consumer trust. Many consumers with low contribution activity are likely to be in casual employment and this employment status may impact their eligibility and suitability for different types of insurance. Creating a positive obligation on funds to make contact with these consumers is likely to boost member outcomes and avoid misunderstanding of policy eligibility at claim time. Providing relevant information at the right time is also far more effective in building consumer awareness when compared to the current reliance on product disclosure statements.

Any member engagement and communication strategy needs to be backed by a strong emphasis on products that are well designed to meet the needs of different demographics. It is unacceptable to default low income casuals into expensive IP policies for which they are likely to derive minimal benefit.

Cessation due to transfer

It is also an opportune time to fix gaps in insurance cover caused by transferring funds. CHOICE was recently contacted by a consumer who was informed her cover only began once her new fund was established. This was three business days after her existing fund had been closed and transferred into her new fund. She was concerned that for three days she was without any cover. This may have been down to poor communication from her existing fund, or a genuine gap in cover. Either way there should be improved consumer protections to prevent consumers from a real or perceived gap in cover due to transfers.

Establish an industry standard for recommencement of cover.

23. Are there any other approaches to deal with this issue?
24. Is this able to be administered?
25. What are the risk controls / insurance risk implications of the above?
26. What administration issues are likely with these proposals?

The discussion paper proposes a number of events upon which cover may be recommenced. Recommencement process should be streamlined and cover any gaps in cover if cessation was due to inadvertent delays in contributions. This would prevent consumers from losing cover in situations outside of their control (e.g. employer contribution non-payment).

Any automatic recommencement of cover should be coupled with a notification which informs a member of the benefits and costs of insurance and their ability to opt-out of cover. This will ensure a consumer is not inadvertently re-entered into an insurance policy without their knowledge.

Duplicate income protection claims protocols

Formalise protocols between insurers for the treatment of claims against multiple income protection policies

27. How will this improve a members experience when making a claim?
28. What else should the protocols consider?

This is a solid improvement in transparency and expectation setting for consumers. For the first time there will be a clear statement of the considerations that go into the deciding which policy a consumer will gain benefit under where they hold more than one. Industry needs to make clear how different aspects of a policy will be weighted to ensure the 'materially better off' test works for individual consumers.

Premium refunds

Industry standards for refunding premiums if benefits are reduced for claims made against multiple income protection policies

29. Should refunds only extend to income protection cover acquired automatically in superannuation or also include income protection cover acquired through member directed action e.g. through an adviser or direct from the insurer, or through industrial agreements? Why?
30. How would insurers of these other policies be covered by industry standards?
31. Should there be a maximum refund period, e.g. last 2 years of premiums only? If so, should this period be aligned with any proposed contribution inactivity period before stopping cover?
32. What administrative impacts will this create for superannuation funds and insurers?
33. How would this be applied to existing automatic IP policies, noting that these may extend back from many years?
34. Is a transition period needed, and if so, how long?

Consumer centric principles should be applied in considering premium refunds. Industry is well aware that in most circumstances disclosure requirements have not been adequate in informing consumers about their inability to gain benefit under multiple IP policies. The Association of Superannuation Funds of Australia (ASFA) research shows that 70% of consumers do not read PDSs or are not aware of them.[9] This is unsurprising when we consider the length of some superannuation PDSs; one study found PDSs ranged between 46-154 pages.[10] If the sector wishes to show it is putting forward truly consumer centric reforms, it should be looking to provide refunds in the broadest set of circumstances.

[9] ASFA, 2016, 'Keynote address delivered by Dr Martin Fahy CEO ASFA National Conference', available at: http://www.superannuation.asn.au/media/speeches
[10] The Provision of Consumer Research Regarding Financial Product Disclosure Documents. Susan Bell Research. Report for the Financial Services Working Group. December 2008.

Consumers now expect more of their service providers; this has been led by a number of digital first service providers that have put the consumer experience at the centre of their business model. For example, online retailer Amazon, which Don Peppers used as an example at the ASFA Annual conference last year, is taking the lead in this consumer centric model. When you order a book through its bookstore you've ordered before, the system will let you know, 'you've already ordered this book, would you like to order it again?' Amazon had the option to make an immediate sale by not warning a customer, but it recognised the long-game of customer loyalty is worth much more. This same principle could be applied in superannuation, if funds played a more active role in discovering consumer needs and provided refunds where a consumer has accidentally double purchased cover. In superannuation there needs to be a refocus to trade off short-term financial gain in exchange for creating long-term loyalty.

Ultimately industry is better placed to determine the affordability of different approaches to refunds. However, industry should be mindful that this measure in particular will be viewed externally as a signal of intent; as such any half-measures may undo the genuine good will behind this reform.

Improving member decision making

Encourage and help members to make informed decisions about their insurance cover

35. What could industry do to better promote and encourage members to consider their insurance?
36. What improvements are needed to the ATO's 'check your super' service?
37. What protocols should funds adopt to proactively identify instances where members have accumulated multiple instances of automatic insurance cover?
38. What communication protocols should superannuation funds adopt once they have identified members with multiple instances of insurance cover?

The discussion paper puts forward a number of sensible proposals to improve consumer decision making which should be adopted as soon as practicable.

An improvement to on boarding new members has the potential to greatly increase consumer engagement. CHOCE is supportive of industry efforts to embed a consolidation option within any fund application, give authority to undertake a SuperMatch and provide targeted information about how to communicate about insurance.

CHOICE research found that one of the major contributors to a lack of trust in superannuation funds was a lack of verbal contact.[11] During our qualitative research we heard from members who had been a member of a fund for 20 years and never even had a call. The proposal to incorporate a welcome call in to the new member sign-up process is likely to be a significant step in rebuilding this trust.

Suggestions for government

Leverage SuperStream, Single Touch Payroll and the ATO's superannuation account database to encourage members to make informed decisions about their insurance cover

39. Is the proposed timeframe in which employers must notify superannuation funds reasonable? Why?
40. What flexibility is required for irregular work patterns, e.g. casual employment, to avoid unnecessary reporting?
41. Should superannuation funds be required to communicate with members once they become aware that employment has terminated?
42. Should Single Touch Payroll be extended to provide a real time view of existing accounts and insurance and allow members to consolidate their existing accounts?
43. Are there any other initiatives that could be explored to identify members with multiple instances of automatic insurance cover?
44. What else can be done to increase visibility and usage of myGov by members?
45. Should the ATO communicate with members or with members' superannuation funds when it identifies that multiple accounts have been established?
46. How could annual tax related activities such as myTax and tax assessment notices, be leveraged to raise awareness of a member's multiple accounts
47. What protocols should be established to allow superannuation funds to use SuperMatch without member consent (subject to enabling legislation/regulations) for the purpose of identifying existing insurance cover and communicating with members?

Many of these proposals are outside of the scope of what an industry code is capable of achieving, but are worthwhile of ongoing discussions with stakeholders, such as government, consumers and employer groups.

[11] Pollinate, 2016, 'Project Superpower – informing a strategy to engage people with their superannuation', Research commissioned by CHOICE, available at: https://www.choice.com.au/~/media/39a3a46234d64be398df0ebaba25c65d.ashx?la=en

For example, improved information from employers about a member's employment status will greatly improve the relevance of fund member communications, but will require a broader conversation with interested stakeholders. We do not intend to comment on these proposals further here, but are open to ongoing conversations with industry.

Enhanced regulatory guidance on the provision of advice

Regulatory guidance on the provision of general advice by superannuation funds that help members make informed decisions

48. To what extent does the current regulatory environment support superannuation fund's efforts to help members make informed decisions about consolidating?
49. What complexities with regulatory guidance prevent superannuation funds from providing general advice because of concerns that it may be deemed personal advice?

The current regulatory environment, but more specifically the way the general advice model has been used by the financial services sector, has led to mass consumer disengagement with financial decision making. CHOICE research found that people are looking for answers, not more 'information' about their superannuation.[12] People wanted to make the right decisions, without the need to be upskilled or 'educated'. Much general advice firmly fits within this unhelpful information that many consumers find impenetrable and lack the time to fully comprehend.

A reliance on using general advice to avoid the increased obligations placed on providing personal advice is in a large part responsible for consumer disengagement. A possible solution is in the development of digital tools which are capable of considering personal circumstances and provide advice on a mass scale for a relatively low cost. There may be consumers for whom this type of a tool will not be sufficient. However, there are large numbers of consumers who are likely to have relatively simple personal considerations for which such a tool would greatly improve decision making.

[12] Pollinate, 2016, 'Project Superpower – informing a strategy to engage people with their superannuation', Research commissioned by CHOICE, available at: https://www.choice.com.au/~/media/39a3a46234d64be398df0ebaba25c65d.ashx?la=en