

SUBMISSION

Royal Commission into
Misconduct in the
Banking, Superannuation
and Financial Services
Industry — Round 6
Insurance in
superannuation policy
questions

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Mr Simon Daley
Solicitor Assisting the Royal Commission

To: Lodged via the online form on the Royal Commission website
Copy to: FSRCsolicitor@royalcommission.gov.au

25 October 2018

Dear Mr Daley

Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (“the Commission”) – Submission in response to the Round 6 Insurance in superannuation policy questions

The Association of Superannuation Funds of Australia (ASFA) is pleased to provide this submission in response to the Commission’s invitation to make written submissions on policy issues in relation to insurance in superannuation raised in Round 6.

ASFA is a non-profit, non-political national organisation whose mission is to continuously improve the superannuation system, so all Australians can enjoy a comfortable and dignified retirement. We focus on the issues that affect the entire Australian superannuation system and its \$2.7 trillion in retirement savings. Our membership is across all parts of the industry, including corporate, public sector, industry and retail superannuation funds, and associated service providers, representing over 90 per cent of the 15.6 million Australians with superannuation.

If you have any queries or comments in relation to the content of our submission, please contact Byron Addison, Senior Policy Adviser on (02) 8079 0834 or by email at baddison@superannuation.asn.au

Yours sincerely

Dr Martin Fahy
Chief Executive Officer

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1. Introduction

The Insurance in Superannuation Voluntary Code of Practice (the Code)

ASFA was a founding member of the Insurance in Superannuation Working Group (ISWG), a broad-based industry group which after consultation with all parts of the industry developed and launched the Insurance in Superannuation Voluntary Code of Practice (the Code) in 2017. The Code commenced on 1 July 2018 with a transition period of three years although it is expected that most funds will be compliant well before that date. Since the dissolution of the ISWG ASFA has become one of the owners of the Code and along with the other Code owners we are currently assisting funds as they develop their transition plans which are due to be completed by 31 December 2018.

The Code currently applies to funds responsible for more than 97% of MySuper members. The Code has already had an impact on the re-design of more affordable and appropriate insurance offerings and given time we are confident it will deliver on its objectives.

This Code is a first for the superannuation industry and sets standards that will provide greater understanding, clearer accountability and consistency of delivery for insurance benefits provided in superannuation across the industry. The Code improves superannuation member value and protections and is a strong step towards enhancing member interests and helping build confidence in life insurance through superannuation.

It is worth repeating what the Code's key features are as they relate closely to the topics identified by the Royal Commission for comment. They are:

- A framework that sets expectations about the maximum amount of superannuation contributions that should be used for automatically provided life insurance premiums
- Simpler and clearer processes for members to opt out of automatic life insurance
- Simplified disclosure and improved superannuation fund member communications about insurance
- Requirements to reduce multiple insurance policies by cancellation of some insurance cover, after funds contact members, in cases where member accounts are inactive and insurance exists
- Provision of better and more timely assistance to members during claims
- Standards for handling of premium adjustment amounts between insurers and trustees
- Requirements for trustees to publish plans for the Code implementation and when various aspects of it will be implemented.

Code governance

We acknowledge calls from some stakeholders to improve the coverage and enforceability of the Code. In regard to this ASFA notes that an option would be for the government to legislate the code provisions, or for a regulator such as APRA, given its standard-making power and existing role in supervising insurance in superannuation, to mandate the Code through a prudential standard.

ASFA recommends that, if the Code were to be mandated, the existing 'if not, why not' approach should be maintained so that trustees are able to exercise discretion where needed in order to act in the best interests of their members.

ASFA will undertake further consultation with the other Code owners over the coming months to discuss possible next steps and will continue to explore with government, regulators and other decision-makers options to strengthen the Code.

Standard insurance definitions will assist superannuation fund members to understand and compare their insurance

ASFA is committed to an industry-led review of standard definitions, which was identified by the ISWG as a project to be pursued as part of phase two of the Code's implementation.

This project would look at the potential for making definitions as standard as possible so that they are easy to understand and allow superannuation fund members to make straightforward comparisons between different products. It should also include a review of the statutory definitions of temporary incapacity and total and permanent disability and the potential for them to contribute to improved insurance outcomes for members. ASFA is conscious that there are risks in standardising definitions relating to constraints on innovation, the tailoring of insurance to the needs of particular member categories and the potential for existing benefits to be affected and of the need for these to be addressed and mitigated.

2. Summary of ASFA’s key positions

The below table denotes ASFA’s key positions in response to the questions raised by the Royal Commission.

Ref:	Royal Commission question	ASFA response
Section F. Insurance in superannuation		
Q. 23	Should universal: 23.1 minimum coverage requirements; and/or 23.2 key definitions; and/or 23.3 key exclusions, be prescribed for group life policies offered to MySuper members?	ASFA considers that the current settings are appropriate and that trustees should remain responsible for setting coverage suited to the needs of their membership. While ASFA supports the standardising of definitions it should be noted that there are risks in making definitions standard, such as the impact on existing insurance benefits. ASFA supports a review of standard definitions and is committed to pursuing this project in 2019.
Q. 24	Should group life insurance policies offered to MySuper members be permitted to use a definition of ‘total and permanent incapacity’ that derogates from the definition of ‘permanent incapacity’ contained in regulation 1.03C of the Superannuation Industry (Supervision) Regulations 1994 (Cth)?	ASFA is of the view that policy definitions should align as closely as possible with the statutory definition. However ASFA notes that the existing definition is open to a number of different interpretations. ASFA considers that the statutory definition should be reviewed as part of any broader review of standard definitions.
Q. 25	Should RSE Licensees be obliged to ensure that their members are defaulted to statistically appropriate rates for insurance required to be offered through the fund under section 68AA(1) of the Superannuation Industry	Yes. The SIS Act, under the insurance covenant (S.52 (7)), already requires that trustees offer appropriate insurance to members. The Insurance in Superannuation Voluntary Code of Practice imposes additional requirements for younger members and other member cohorts, and a 1% cap on premiums.

Ref:	Royal Commission question	ASFA response
	(Supervision) Act 1993 (Cth)?	
<p>Q. 26 and 27</p>	<p>Should RSE Licensees be prohibited from engaging an associated entity as the fund’s group life insurer?</p> <p>Alternatively, should RSE Licensees who engage an associated entity as the fund’s group life insurer be subject to additional requirements to demonstrate that the engagement of the group life insurer is in the best interests of beneficiaries and otherwise satisfies legal and regulatory requirements, including the requirements set out in paragraphs 22 to 24 of Prudential Standard SPS 250, Insurance in Superannuation?</p>	<p>There is no overwhelming evidence to support a prohibition on particular structures within superannuation. The focus should be on strengthening conflicts management and regulatory frameworks to facilitate improved conduct and outcomes for consumers.</p> <p>Related party service providers:</p> <p>ASFA acknowledges that there are significant existing statutory and prudential obligations on trustees in using related party service providers. However we consider that a requirement to more rigorously validate the selection of related party service providers could strengthen industry practice and improve conflicts management. Mechanisms to achieve this could include:</p> <ul style="list-style-type: none"> • enhanced assurance processes to provide comfort that arrangements are in the best interests of fund members • rigorous benchmarking that demonstrably supports the trustee’s decision

Ref:	Royal Commission question	ASFA response
<p>Q. 28 and Section I. Compliance and Breach Reporting</p> <p>Q. 39</p>	<p>Are the terms set out in the Insurance in Superannuation Voluntary Code of Practice sufficient to protect the interests of fund members? If not, what additional protections are necessary?</p> <p>Are there any recommendations in the 'ASIC Enforcement Review Taskforce Report', published by the Australian Government in December 2017 that should be supplemented or modified?</p>	<p>ASFA considers that the Code has already had a positive impact on the provision of insurance in superannuation with a number of funds having reduced premium costs and adjusting insurance policy design to ensure their insurance benefits are better targeted. We consider these positive impacts will continue as the Code is implemented and it should be given time to deliver on its objectives.</p> <p>ASFA acknowledges calls from some stakeholders to improve coverage and enforcement of the Code. In regard to this:</p> <ul style="list-style-type: none"> • ASFA notes that one option is for government to legislate the code provisions, or for a regulator such as APRA, given its standard-making power and existing role in supervising insurance in superannuation, to mandate the Code through a prudential standard. • ASFA considers that if the Code was mandated, the existing 'if not, why not' approach should be maintained so that trustees can exercise discretion where needed to protect their members. <p>ASFA is supportive of working with the Government, regulators, and other relevant stakeholders to advance the Code.</p>
Related questions		
<p>B. Disclosure</p> <p>Q. 6</p>	<p>Is there scope for insurers to make greater use of standardised definitions of key terms in insurance contracts?</p>	<p>ASFA supports the exploration of standard definitions and is committed to pursuing this project in 2019.</p> <p>ASFA, in general, supports measures that promote the use of plain English and that make financial products such as insurance policies easy to understand and compare.</p>

3. Insurance in superannuation

3.1. Insurance for MySuper members

Q 23 Should universal:

23.1 minimum coverage requirements; and/or

23.2 key definitions; and/or

23.3 key exclusions,

be prescribed for group life policies offered to MySuper members?

ASFA considers that the existing MySuper minimum requirements are broadly appropriate and that the setting of insurance coverage beyond those minimum levels should be left to trustees to determine what is suited to the particular needs of their members.

ASFA notes that the *Protecting your Super package* proposals will act to reduce existing coverage for MySuper members. We have argued for those proposals to be amended in various ways to achieve a better balance between providing insurance benefits and minimising the impact this has on retirement savings. In particular we recommend:

- Changing the minimum age that automatic cover can be provided to new members to 21
- Allowing new members over any prescribed minimum age being provided with automatic cover immediately upon joining a fund without having to accrue a \$6,000 balance
- Removing the obligation on funds to cease death, terminal illness and TPD insurance for inactive accounts when the balance is over \$6,000
- Introducing further exemptions to allow funds to provide (and continue to provide) insurance on an opt-out basis to members in higher risk occupations and to allow for legacy products that are “paid up” to not be impacted to the detriment of members.

ASFA supports making definitions within insurance as standard as possible with the qualification that in doing so innovation and tailoring of insurance for the needs of particular members are not unduly affected. We are also concerned that existing benefits are not curtailed or reduced. To this end we will participate in an industry-led review of standard definitions which is due to commence early in the new year.

Further information about ASFA’s position with regard to the industry-led review of standard definitions can be found in the answers to questions 6 (p.10) and 24 (p. 7).

ASFA considers that the existing minimum requirements for MySuper are broadly appropriate.

ASFA supports the standardising of definitions where innovation and tailored benefits are maintained and existing member insurance benefits are protected.

3.2. Total and permanent incapacity definition

Q 24 Should group life insurance policies offered to MySuper members be permitted to use a definition of ‘total and permanent incapacity’ that derogates from the definition of ‘permanent incapacity’ contained in regulation 1.03C of the Superannuation Industry (Supervision) Regulations 1994 (Cth)?

ASFA is of the view that insurance policy definitions should align as closely as possible with the statutory definition. However ASFA notes that the existing definition is open to a number of different interpretations. Some of our members also regard it as a constraint on introducing measures to help members to return to work where this is possible.

ASFA considers that the statutory definition should be reviewed. We are committed to pursuing a broader industry-led review of standard definitions in 2019 and it is anticipated that this will include a review of the current definition in regulation 1.03C.

There are a number of ways to approach making definitions standard as well as a number of risks in doing so. The benefits of standard definitions - simplicity and ease of comparison - need to be balanced against the impact on existing benefits, and the constraints on innovation and the ability of trustees to tailor insurance to the particular needs of their members.

3.3. Appropriate premium setting

Q 25 Should RSE Licensees be obliged to ensure that their members are defaulted to statistically appropriate rates for insurance required to be offered through the fund under section 68AA(1) of the Superannuation Industry (Supervision) Act 1993 (Cth)?

ASFA considers that the existing statutory obligations for trustees and the introduction of the Code already act to ensure ‘statistically appropriate defaults’ for members.

The SIS Act, under the insurance covenant (S.52 (7)), already requires that trustees offer appropriate insurance to members. Prudential Standard *SPS 250 Insurance in Superannuation* also imposes requirements for a trustee’s insurance management framework and insurance arrangements more generally which relate to the appropriateness of insurance benefits provided.

We also note that ASIC has indicated in its recent *Report 591: Insurance in superannuation* that it will use its existing powers to “ensure trustees stop treating members as ‘smokers’ by default”.

The Code also requires trustees to consider the appropriateness of insurance for different member categories and imposes additional requirements for younger members and other member cohorts, and a 1% cap on premiums. Where trustees cannot meet certain requirements under the Code they are required to publish their reasons in an annual Code compliance report.

ASFA considers that the Code, in tandem with the existing statutory and prudential obligations, should provide sufficient protections for members and minimise unnecessary account erosion. At the same time the Code provides trustees with a degree of flexibility to enable them to offer insurance adapted to the particular needs of their members, such as those employed in hazardous occupations. It should be given a chance to be implemented so that it can deliver on its objectives

ASFA considers that the existing statutory obligations along with the requirements imposed by the Insurance in Superannuation Voluntary Code of Practice should provide sufficient protection for members against the risk of excessive insurance premiums caused by inappropriate employment or health default categories.

3.4. Related party service providers

Q 26 and 27 Should RSE Licensees be prohibited from engaging an associated entity as the fund's group life insurer?

Alternatively, should RSE Licensees who engage an associated entity as the fund's group life insurer be subject to additional requirements to demonstrate that the engagement of the group life insurer is in the best interests of beneficiaries and otherwise satisfies legal and regulatory requirements, including the requirements set out in paragraphs 22 to 24 of Prudential Standard SPS 250, Insurance in Superannuation?

As we have previously argued in our response to the policy questions arising from Round 5 (superannuation hearings) there is no overwhelming evidence to support a prohibition on particular structures within superannuation.

The focus should be on strengthening conflicts management and regulatory frameworks to facilitate improved conduct and outcomes for consumers.

With regard to related party service providers, we note that APRA Prudential Standards and Guidance prescribe a number of requirements for trustees to meet when outsourcing to related bodies corporate. These include *SPS 220 Risk Management*, *SPS 510 Governance*, *SPS 521 Conflicts of Interest*, *SPS 231 Outsourcing* and related guidance material. We also note that APRA intends to strengthen the outsourcing and business case requirements for trustees under SPS 220 as part of its *Strengthening superannuation member outcomes* package.

Properly managed, there can be efficiency, cost and risk management benefits associated with providing superannuation and insurance products through an integrated financial services organisation. Trustees have typically used a variety of mechanisms, such as due diligence and market surveillance, to test the competitiveness of arrangements that are in place.

A requirement to more rigorously validate the selection of related party service providers could strengthen industry practice and improve conflicts management. One possible mechanism might be to require enhanced assurance processes that provide additional comfort around the trustee's decision. This could include review of the determination by relevant committees, internal auditors, or an appropriately qualified independent third party. Another would be to require rigorous benchmarking be undertaken that demonstrably supports the trustee's decision.

ASFA considers that a requirement to more rigorously validate the selection of related party service providers could strengthen industry practice and improve conflicts management. Mechanisms to achieve this could include:

- enhanced assurance processes to provide comfort that arrangements are in the best interests of fund members
- rigorous benchmarking that demonstrably supports the trustee's decision.

3.5. Insurance in Superannuation Voluntary Code of Practice (the Code)

Q 28 Are the terms set out in the Insurance in Superannuation Voluntary Code of Practice sufficient to protect the interests of fund members? If not, what additional protections are necessary?

Section I. Compliance and Breach reporting

Q 39 Are there any recommendations in the 'ASIC Enforcement Review Taskforce Report', published by the Australian Government in December 2017 that should be supplemented or modified?

As a Code owner ASFA supports the Code and considers that its key features will lead to significant improvements in the delivery of insurance through superannuation to members. Its key features are:

- A framework that sets expectations about the maximum amount of superannuation contributions that should be used for automatically provided life insurance premiums
- Simpler and clearer processes for members to opt out of automatic life insurance
- Simplified disclosure and improved superannuation fund member communications about insurance
- Requirements to reduce multiple insurance policies by cancellation of some insurance cover, after funds contact members, in cases where member accounts are inactive and insurance exists
- Provision of better and more timely assistance to members during claims
- Standards for handling of premium adjustment amounts between insurers and trustees.

ASFA acknowledges that there have been calls from some stakeholders to improve coverage and enforcement of the Code.

In regard to this ASFA notes that one option is for government to legislate the code provisions, or for a regulator such as APRA, given its standard-making power and existing role in supervising insurance in superannuation, to mandate the Code through a prudential standard.

ASFA considers that if the Code was mandated, the existing 'if not, why not' approach should be maintained so that trustees can exercise discretion where needed to protect their members.

ASFA will undertake further consultation with the other Code owners over the coming months to discuss possible next steps and will continue to explore with government, regulators and other decision-makers options to strengthen the Code.

ASFA is supportive of working with the Government, regulators and other relevant stakeholders to advance the Code.

4. Related questions

4.1. Standard definitions

Section B Disclosure

Q 6 Is there scope for insurers to make greater use of standardised definitions of key terms in insurance contracts?

ASFA supports the use of standard definitions to the greatest extent possible and is committed to pursuing this objective by undertaking an industry-led review in 2019.

There are a number of ways to approach making definitions standard as well as a number of risks in doing so. The benefits of standard definitions - simplicity and ease of comparison - need to be balanced against the impact on existing benefits, and the constraints on innovation and the ability of trustees to tailor insurance to the particular needs of their members.

The review of standard definitions is expected to have two parts: what the industry can do to make definitions as standard as possible; and how the existing statutory definition of total and permanent disability and temporary incapacity interact with the definitions and interpretations used within the industry and whether they can be improved.

ASFA, in general, supports measures that promote the use of plain English and that make financial products such as insurance policies easy to understand and compare.

In pursuing such a project it is important also to acknowledge the risks that making definitions standard might pose and mitigate or avoid them. These risks are:

- The potential for existing insurance benefits to be reduced or limited through a change in definition
- The introduction of constraints on trustee's ability to tailor insurance to the specific needs of its membership
- Constraints on innovation, for example in the development of insurance products, claims management or return-to-work strategies.

Acknowledging the complexity and challenges in this field, the aim of the project will be to ensure that:

- insurance benefits are described in plain English that is easy to understand
- members are able to determine easily what they are insured for and what they are not insured for
- members are placed in a position which allows them to easily compare different products.

ASFA supports the exploration of standard definitions and is committed to pursuing this industry-led project in 2019.

ASFA, in general, supports measures that promote the use of plain English and that make financial products such as insurance policies easy to understand and compare.

5. Conclusion

ASFA is a strong advocate for the benefits of insurance in superannuation and was a founding member of the Insurance in Superannuation Working Group (ISWG) and we are now a Code owner. We are committed to the implementation of the Code and to pursuing an industry-led review of standard definitions.

It is our view that the Code will address many of the issues identified by the Royal Commission in its Round 6 hearings. However as we are still in process of implementation, the Code needs to be given time to deliver on its objectives before an evaluation of its benefits can be undertaken.

We do, however, acknowledge calls from some stakeholders to improve the coverage and enforceability of the Code. In regard to this ASFA notes that an option would be for the government to legislate the code provisions, or for a regulator such as APRA, given its standard-making power and existing role in supervising insurance in superannuation, to mandate the Code through a prudential standard.

ASFA will undertake further consultation with the other Code owners over the coming months to discuss possible next steps and will continue to explore with government, regulators and other decision-makers options to strengthen the Code.