Discussion Paper: Account balance erosion due to insurance premiums.

March 2017

The Insurance in Superannuation Working Group

CONTENTS

ISWG Foreword

Group insurance in superannuation, and particularly its automatic issuance on an opt-out basis, has been a successful policy for Australia which has resulted in better risk protection for Australians from all walks of life. It provides a safety net to millions of Australians who would have otherwise not chosen or been unable to take out life and disability insurance individually. These benefits contribute significantly to addressing Australia's underinsurance gap and relieving fiscal pressures on our social security system.

The Insurance in Superannuation Working Group (ISWG) was formed in November 2016 to collaboratively enhance future iterations of policy development. While the current policy settings are fundamentally right, there is industry acknowledgment that changes need to be made to improve the experiences of superannuation fund members.

Members need to be placed in the middle of a complex stakeholder hierarchy with clarity that superannuation funds are advocating on their behalf. Superannuation funds and insurers must work together in order to achieve the most sustainable benefits for members. Accordingly, the ISWG contains superannuation fund, insurer, industry and consumer representatives.

The ISWG believes that:

The objective of insurance in superannuation is to provide a measure of financial support to members and their families if the member is prevented from working to retirement age by death or ill-health.

This objective has to be balanced with the broader purpose of superannuation being the provision of retirement benefits for those that do have a full working life, recognising that insurance premiums will erode those sums to some extent. The challenge for superannuation funds is managing these competing objectives and making sure that the balance between meeting needs and affordability is appropriately established and managed into the future.

A key deliverable for the ISWG is a Code of Practice that will apply to superannuation funds. This code will extend on the current Life Insurance Code of Practice by setting standards that ensure a common end to end experience for all classes of life insurance consumers.

This discussion paper is the first of several that will focus on key issues that need to be addressed by the industry. Feedback received from these discussion papers and other stakeholder consultations will inform the development of the Code of Practice and Good Practice guidance for superannuation funds.

The scope of this first paper - Account balance erosion due to insurance premiums - was selected because the ISWG believes it is one of the most important areas where change is required and where some immediate corrective actions can be implemented by the industry. Later discussion papers will address matters relating to: claims handling; improving member communication and engagement; benefit design and the better use of technology to enhance efficiency.

Unless stated otherwise, the statements in this paper reflect the views of the ISWG as a collective.

EXECUTIVE SUMMARY

The superannuation and life insurance industry recognises that insurance premiums can have a significant impact on the retirement savings of members - particularly younger and older members and those with low incomes and/or low account balances. This has to be considered against the reality that for many Australians, the only life insurance cover they have is provided on an automatic basis by their superannuation fund.

Rice Warner estimates that 71% of death cover, 88% of total and permanent disablement and 59% of income protection coverage in Australia is provided through superannuation[1]. Despite this coverage insurance at an individual level may be insufficient to meet the needs of members or their beneficiaries.

Currently all MySuper products are required to automatically provide Death and Permanent Incapacity (commonly referred to as Total and Permanent Disablement Insurance or TPD) to members on an opt out basis. They may also choose to provide Income Protection insurance automatically. A SIS Act covenant obliges superannuation funds to only acquire or offer insurance of a particular kind or at a particular level if the cost of the insurance does not inappropriately erode the retirement income of beneficiaries[2].

In this paper we will discuss the key issues that may be unnecessarily contributing to account balance erosion due to automatic insurance and propose some solutions to reduce this.

The ISWG considers that the key issues contributing to account balance erosion, in its simplest form are the premium amounts being charged and multiple automatic insurance policies.

To address these issues, this paper proposes the following industry actions:

- a set of defined insurance principles that will assist superannuation funds to make decisions on insurance design for different cohorts of members
- there be a defined maximum premium level that can be charged for automatic insurance
- there be a defined and consistent definition across funds, for when insurance cover ceases and recommences
- formalisation of protocols between insurers for the treatment of claims against multiple income protection policies
- the establishment of standards for refunding premiums for claims made against multiple income protection policies
- assisting members to make informed decisions about the insurance they hold in superannuation

Whilst this paper has a strong focus on cost, it is not intended to override the importance of providing cover that is aligned with member needs and affordability. This is consistent with the system level objective for insurance adopted by the Productivity Commission - the superannuation system provides value for money insurance cover without unduly eroding retirement balances[3].

[1] Rice Warner – Insurance in Superannuation 2016.
[2] SIS Act, s. 52(7)(c)).
[3] Productivity Commission – Inquiry into the Efficiency and Competitiveness of Superannuation (final report -2016)

We have intentionally raised and discussed solutions in the first instance that do not require regulatory or legislative change, because we want this paper to focus on changes that can be made by the industry itself. The ISWG acknowledges that there are more solutions that would become possible with regulatory or legislative change and we have noted these in section C: Further considerations. We invite your thoughts on these areas as well but the focus of this discussion paper is on actions the industry can take itself, without regulatory or legislative assistance.

We encourage and welcome all stakeholders to respond to these proposals with their thoughts and feedback. The ISWG wish to ensure that all voices are heard and considered, in working towards the goal of providing industry leadership and mandating a high standard of delivery that gives consumers confidence in the system.

We want your feedback

We invite you to comment on the key questions that have been raised. All submissions on this discussion paper are due by **7 April 2017** and should be sent to the Project Managers Office at:

ISWG-PMO@kpmg.com.au

All submissions will be treated as public documents unless you specifically request that we treat the whole or part of your submission as confidential.

SECTION A: DISCUSSION

A.1 Automatic insurance members

For the purposes of this paper superannuation fund members are automatic insurance members, if when joining a superannuation fund insurance is issued under an automatic acceptance limit, unless:

- They make an active declaration to the superannuation fund to maintain the automatic cover provided (which the fund will need to record)
- They make an application for cover (including through choice of fund, underwriting or reinstating previous cover)
- They vary their cover in any way (*e.g. opting out* fixing cover or changing benefit or waiting period)
- They have joined an employer plan and are having their insurance premiums funded by their employer
- They are a defined benefit member

The proposed solutions in section B of this paper will result in a superannuation fund being required to ensure that automatically issued insurance is designed in a way that complies with the principles of this paper. If a benefit design structure is chosen by a party that is not the superannuation fund, a sponsoring employer for example, the fund still remains responsible for ensuring the benefit design complies. The only exception to this would be if the employer had chosen a design and was funding the premiums for this design on behalf of its employees. However, the member would become an automatic insurance member if the employer were to cease funding the premiums, such as when the member leaves the employer. The superannuation fund would then be required to ensure that any continued coverage is in line with the principles the superannuation has adopted for other automatic insurance members.

For the purposes of clarity, where the premiums are paid for by an employer or not paid by deduction from a members account (which is common in defined benefit funds) superannuation funds will not be required to comply with these guidelines. However, affordability and appropriateness of the cover, including the balance between the retirement benefit being paid if it is a formula-based benefit in the case of defined benefits should still be considered by the superannuation fund.

A.2 Automatic insurance design

Insurance benefit design is not mandated by the government and superannuation funds have flexibility to design automatically issued products to suit the membership. The fund Trustee plays a vital role and has ultimate accountability in setting the benefits for its membership.

In accordance with APRA Prudential Standards (SPS 250) superannuation funds are ordinarily expected to contain within a broader Insurance Management Framework an Insurance Strategy.

The strategy should demonstrate that decisions relating to making insured benefits available to members were made with reference to the collective best interests of beneficiaries as a whole as well as the financial interests of MySuper members[4].

There are varying approaches to how automatic cover is set across the industry. Some superannuation funds have opted to mirror the levels set out in the Superannuation Guarantee (SG) legislation which requires minimum levels of Death cover, which tier down from $50,000 from age 20[5]. Others have retained or introduced alternative insurance designs which provide higher levels of cover and include TPD and Income protection insurance cover reflecting the needs of their memberships. It is becoming increasingly common for superannuation funds to segment their members based on factors like age, gender, occupation and sub plan membership and then vary the levels of cover provided and/or premiums charged.

Across funds, membership and employer group's demographics can vary considerably. Some funds have a higher proportion of younger or older members than others. Others have more males than females, and vice versa. In addition, occupation types and employment types (Full Time, Part Time and casual) will vary from fund to fund.

When MySuper was introduced and the obligations that these products compulsorily provide insurance to members commenced some funds simply replicated the cover levels detailed in the legislation while others maintained their existing designs as they exceeded the prescribed minimums and the remaining implemented new designs.

Some superannuation funds have also maintained an insurance design that was integrated with the Member Protection Rules that applied for administration fees (but not insurance premiums) from 1995 to 2013. These rules protected members who had an account balance of less than $1,000. Whilst these rules were abolished on 1 July 2013, many funds have chosen to maintain a requirement that insurance cover will cease if a member's account balance falls below this or some other a pre-defined level as a means to help protect accounts from erosion from premiums.

A.3 Balance erosion risks

There is a lack of consistent understanding of what is an inappropriate erosion of retirement income for automatic insurance cover and this is compounded by their not being any specific regulatory guidance or industry benchmarks defining such. Currently there are widespread concerns being expressed, including from government that automatic insurance premium levels are too high, resulting in an unacceptable erosion of balances for too many superannuation fund members.

Premium amounts

As at 31 December 2016, the range of cost of default coverage is significant. For some funds, basic default coverage has been maintained at $0.50 a week, whilst others have default costs that exceed $20 per week, and which may vary by the age, occupation, salary or contribution level, and gender of the member. The cost per week varies greatly due to:

- Composition of the funds chosen cover types (Death, TPD and IP)

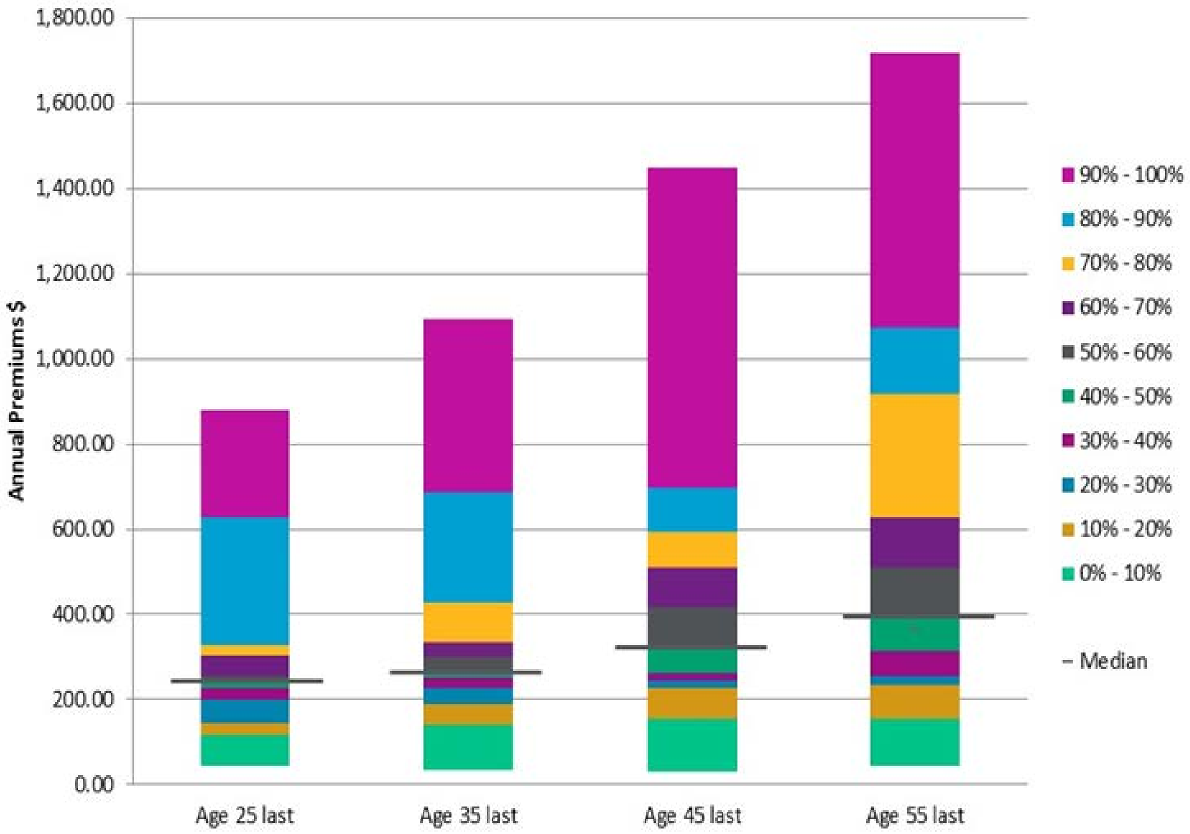
[4] APRA – SPS 250

[5] Superannuation Guarantee (Administration) Regulations 1993 – Regulation 9A

- Levels of default coverage (which can vary in funds by employer plan)
- Gender
- Occupations of the members being provided with cover (and whether occupational ratings are applied)
- Mix of full time, part time and casual membership
- Each fund and/or employers own claims history

The chart below illustrates the total default insurance costs contained in publicly available PDS documents available in June 2016, then breaks up the 54 funds analysed into 10% bands. Where multiple occupation groupings are offered by a fund, the white collar group has been used. The median default insurance costs are represented by the upper boundary of the "40% to 50%" band, being $240 p.a. at age 25, $260 p.a. at age 35, $324 p.a. at age 45, and $395 p.a. at age 55[6].

Chart 1 - Range of total annual default premiums



Meeting needs

In addition to views on inappropriate account balance erosion from a pure premium perspective, there are concerns that some of the current design structures do not accurately reflect the needs of the members who are provided these benefits. On the one hand, for many members, the level of cover is likely to be inadequate to meet their ongoing needs (in the event of disability), or of their dependents (in the event of death). On the other hand, there may be over-insurance for younger Australians without dependents, or for those who are nearing retirement for whom insurance costs can be relatively expensive as examples.

[6] Willis Towers Watson – Default Insurance Design September 2016.

Insurance cessation

For many superannuation products insurance cover will continue until members meet defined balance thresholds or other conditions like reaching a maximum expiry age. Some group insurance policies do contain a trigger which cancels cover for members when a defined period of inactivity is reached, however these cover ceasing rules are not universal, leading to confusion amongst members as to what rules apply to them. Insurance cover also ceases when the account is transferred to an Eligible Rollover Fund (ERF) or to the Australian Tax Office (ATO).

The transition to insurance cover provided on an account basis rather than on a contributions basis, which was intended to minimise any gaps in cover for members between jobs, also creates balance erosion risks.

Increasing claims

Over the last few years, the insurance industry has experienced a significant increase in the number of claims being made through group insurance policies. The disparity between the volume of claims and the premiums being charged has led to an increase in insurance costs for many funds.

A.4 Duplicate insurance

Instances of members holding multiple superannuation accounts, and by extension multiple instances of automatic insurance cover, typically occurs when members change jobs, name or address, or have more than one job. Many employees don't inform their new employer of their current fund, in some cases because of a positive intent to join their employer's default fund however many do not end up taking steps to consolidate existing accounts into the new fund. In addition, where an employer selects a new default MySuper fund, many employees will then accumulate a new account unless a Successor Fund Transfer (SFT) occurs, the employee chooses their current fund or they take action to consolidate into the new fund.

There are some key drivers that underpin the proliferation of member's accumulating multiple instances of automatic insurance cover:

- Low member awareness and engagement with superannuation and life insurance generally
- Increased mobility and casualisation of the workforce leading to multiple memberships in different funds
- Account consolidation is perceived as too much effort relative to the benefit
- Insurance policy design doesn't generally cater for members who accumulate multiple superannuation accounts

A number of the Stronger Super reforms have sought to address the instances of multiple accounts. This is having some impact, with an upward trend in the number of single account holders evident according to the ATO's superannuation accounts data overview[7]. Further government initiatives are underway, including increases to the balance thresholds for transfer of lost inactive accounts to the ATO, greater utilisation of myGov and SuperMatch, ASIC's MoneySmart website and the transfer of accrued default amounts by 1 July 2017, which will further reduce the number of multiple accounts.

[7] ATO - Super Accounts Data Overview, 2016 (https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Super-statistics/Super-accounts-data/Super-accounts-data-overview/).

The introduction of Single Touch Payroll from 1 July 2017 also provides greater control for employees to proactively choose their preferred superannuation fund through online access and pre-population of choice forms.

In addition, funds have increased the frequency and expanded the mediums through which they communicate with their members on the importance of consolidating superannuation and insurance and considering whether their existing insurance cover meets their needs.

In spite of this, it is estimated[8] that as many as 25% of superannuation accounts who had insurance premiums deducted had no contribution for at least 12 months. Industry can identify multiple accounts at an aggregate industry wide level, however the ATO SuperMatch service can only be used by a superannuation fund where member consent has been provided.

A.5 Member engagement and awareness

Whilst there is a proportion of members who obtain insurance automatically as part of their superannuation account that are aware and engaged with their cover, there is another proportion that are not.

Similarly, there are a proportion of members who make an active choice to maintain multiple superannuation accounts for the purpose of maintaining insurance cover. This is particularly the case for death and TPD cover where a member, or their beneficiaries, is generally eligible to receive multiple benefits upon claim.

Any industry action will need to consider those members who have made an active election regarding their insurance, including those who have remained with intent, on the automatic benefits as elected by the superannuation fund on their behalf. However many other members with multiple instances of insurance cover do not make any election and may be unaware that they hold insurance cover at all.

[8] Rice Warner - Affordability of Group Insurance in Superannuation, December 2016

Section B: Proposals

In respect of automatic insurance members, there are a number of solutions that could be implemented to reduce the likelihood that premiums will unduly erode member account balances. Feedback is sought on these proposed solutions.

Proposed solutions

1. Establish design principles to be adhered to when determining automatic cover and affordable premium levels including:
    - General considerations applying to all members
    - Specific consideration of appropriateness and affordability of automatic insurance for young members and members close to retirement
    - Affordability considerations applying to all members
2. Establish overarching prescribed maximum premium levels for automatic insurance coverage
3. Establish industry standards for ceasing and re-commencing automatic cover
4. Formal protocols between insurers for the treatment of claims against multiple income protection policies
5. Industry standards for refunding premiums if benefits are reduced for claims made against multiple income protection policies

B.1 Benefit design principles

The purpose of these principles for automatic insurance benefit design is to provide guidance to superannuation funds and to a certain extent employers, on how automatic coverage should be designed. Enough flexibility should remain to ensure that funds with, for example a higher proportion of blue collar workers, or members who are not employed on a full time basis, can continue to be able to provide cover that is of value to their membership.

The introduction of these principles will provide comfort to consumers that automatic insurance designs chosen by the superannuation fund are appropriate and are not unduly eroding their retirement savings. Each fund will be required to demonstrate that they have considered this when setting or evaluating their benefit designs.

A set of guiding principles could be reflected in a Code to assist superannuation funds when redesigning their automatic insurance offerings. These principles should be designed to give funds reasonable flexibility to ensure that their insurance design remains appropriate to their own member demographics. Consistent with SIS and SPS250, in determining automatic cover types, cover levels and associated premiums levels a Code could prescribe the following principles:

General considerations

Assessment of their Fund's membership insurance needs taking into account their;

- Age
- Gender
- Industry and occupations
- Salary
- Employer contribution levels
- Claims history
- Insurability outside automatic arrangements
- Member feedback based on member research and attitudes to insurance

A Code may also require the consideration of other indicators of member's needs. This data could be either held by the fund, although some may have to be sourced from external data sources including the ABS Statistics:

- Marital status
- Number of dependents
- Household debt

The Code could require that the resultant determination could be tested across the whole membership and specific cohorts or segments rather than necessarily for each individual member. However, the insured membership should be adequately segmented to ensure that this assessment is performed for a meaningful group of like members. That segmentation could pertain to age, occupation etc. The Code would not restrict superannuation funds performing this analysis at a lower level if they so desired.

This assessment should result in the determination of which types (including potentially varying levels of Death and TPD and Income Protection, if applicable) and levels of cover are appropriate for their membership at varying ages.

Specific considerations

Specific concerns about the erosion of premiums have focused on two major cohorts: young members (under 25 for this paper) and members nearing retirement (members over 55 for this paper). A Code could require that an assessment is undertaken at a minimum for younger members and nearer to retirement members to determine the appropriate level of cover for these cohorts.

Superannuation funds may want to consider that for younger members, modest levels of death cover (for example $50,000) to cover expenses in the event of untimely death may only be required. Greater attention could then be given to the greater risk that younger people face namely being unwell and unable to work, and to allocate premiums for automatic insurance coverage to support higher disablement benefits.

For young members, any requirements in a Code could include a strong focus on:

- the appropriate types of cover (whether Death and/or Disability cover is required and at what level)
- the impact of premiums on these members who typically have low account balances
- their working patterns, a casual employee where contributions could be ad-hoc may need to be considered differently to a full time or part time regular low income member

- reference to the number of dependents and liabilities levels (if these can be ascertained)
- the level of cross-subsidisation (if any) between young and other members.
- how members can opt back in or re-commence cover if they have previously opted out

For nearer to retirement members it is expected that there will be a strong focus on:

- the appropriate types of cover (whether Death and/or Disability cover is required and at what level)
- the impact of high premiums associated with cover for members at this age
- the need to maintain account balances as members approach retirement

Affordability considerations

Once a superannuation fund has determined the insurance requirements of their membership, they must then undertake an assessment to determine whether those levels are affordable and do not inappropriately erode their membership's retirement incomes, noting that this could vary based on the different cohorts within the fund. Where they do not meet this test, the superannuation fund should adjust cover levels or other factors impacting cost such as terms, conditions or definitions until they fall within the pre-defined thresholds.

It is proposed that there should be a standardised approach to setting the maximum premium level of automatic cover. Current proposed methodologies include:

- a percentage of employer contributions
- a percentage of salary or of average weekly earnings
- a percentage of account balance
- a percentage of projected account balance at retirement
- a straight dollar limit

The final approach may reference a combination of the above.

It is anticipated that the prescribed limits will have sufficient flexibility to allow for:

- Different occupation categories, higher limits for those members in heavy-blue and higher risk occupations for example
- Different employment patterns like higher or lower incidences of casual or part time employment

B. 1 Feedback questions

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?

   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?
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?
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?

B.2 Maximum premium levels

As has been mentioned, the SIS Act requires that insurance premiums do not inappropriately erode account balances and ultimately retirement incomes, however it does not define this or provide guidance as to how this requirement should be satisfied. A standard definition of 'inappropriately erode' could provide clarity to members, funds and insurers on what this term means in practice. A Code could include this definition or interpretations of this term with reference to measures that can be used as an objective measure of compliance.

The definition could make reference to:

- the anticipated cumulative impact on account balances at retirement
- interaction with anticipated contribution levels and net investment

Premium thresholds

Either as an alternate or in addition to the aforementioned design principles, a Code could include maximum thresholds that sit alongside the superannuation fund's obligation to determine their own thresholds. A fund could still determine maximum premium levels that are below the prescribed maximum thresholds but not above them.

The Code could require that premium levels not exceed any or a combination of the following criteria:

	Young member **< 25**	**Older Members** **> 55**	**Other members** **26 - 55**
$$ premiums	$$	$$	$$
% employer contributions or salary	x% (lower)	x% (higher)	x% (medium)
% of account balance	na	x% (lower)	x% (higher)
% of projected account balance at retirement	x%	x%	x%
% of Automatic Insurance Members who satisfy either the %Salary or % of account balance test	y%	y%	y%

It is anticipated that these parameters could be established with reference to:

- industry feedback
- consumer research
- actuarial modelling
- historical claims experience
- current taxation requirements
- other factors (to be determined)

Each of the above measures may be more or less relevant for the different age groups as considered below:

- Measuring affordability using % of SG contributions is a simple, easy metric. This measure also recognises the different affordability levels of members with high regular contributions (older and other) compared to those with low regular contributions. Young members with low account balances will rely on contributions to prevent erosion.

- Measuring affordability using % of account balances is also a simple, easy metric based on the premise that an existing account balance can also be used to finance insurance premiums. The headline measure could be set in reference to expected investment returns. This measure can also recognise the different affordability levels of members with high account balances compared to those with low account balances. Older members, heading into retirement may be earning more therefore, justifying a higher % measure against SG contributions, however they may also be assumed to be focused on stabilising their retirement balances, justifying a lower % measure against account balances.

- Setting a maximum premium expressed in $, while a simple measure, makes no distinction between the differing affordability levels of different members, different regular contribution levels or account balances as examples.

- An affordability measure based on % of projected account balance at retirement is the ultimate aim, however it is a more complicated metric requiring individual retirement projections. Metrics based on % SG contributions and % account balances can however be designed and set to achieve the desired effects on projected account balances. For example, the adoption of a lower SG contribution measure for young members recognises not only a reduced need for insurance at younger ages, but also the compound interest effects of building up an account balance early in a person's career, which has a disproportionate positive effect on projected retirement balances. Similarly, a lower account balance measure for older members is designed with projected retirement balances in mind.

In determining whether a fund has complied with these requirements the Code could set out a requirement that over a fund's whole membership a predefined % of automatic insurance members should satisfy one of the measures. It is a relatively simple process for funds to individually test each of their members against both the % of SG contributions measure and % of account balance measure. An 'at risk member' could be defined as a member who breaches either of these measures. Over a fund's whole membership a measure could be set that a predefined % of automatic insurance members should satisfy one of the measures.

B. 2 Feedback questions

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?

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? Upon the expiry of premium guarantee periods? Every three years? Whenever prices or automatic insurance levels are changed?
13. Should there be one set of maximums or should they differ between different occupational age groups?

B.3 Ceasing and re-commencing cover

Another solution to address the erosion of superannuation balances due to insurance is to stop cover below certain balance or contribution thresholds. However, consideration needs to be given to the issue that insurance cessation may not be in the best interests of a member, especially if there is no re-commencement provisions.

Cessation

Increasingly we are seeing some funds give consideration to the ATO's lost super (small and insoluble) threshold guidelines to set the minimum account balances for automatic insurance purposes. Currently this threshold is $6,000[9]. At the same time, these funds try to communicate with members prior to cover ceasing, so that affected members can elect for cover to continue if they still want it.

It is anticipated that a Code will include requirements for superannuation funds to undertake a specific assessment of the circumstances under which they will automatically lapse automatic cover for members for whom there have been no contributions or balances are at a very low level. The cohorts that superannuation funds will be required to assess will include:

- automatic insurance members with low balances
- members with contributions inactivity
- members with low contributions activity
- younger and nearer to retirement members

The Code could require a superannuation fund to take a prescriptive position on a minimum requirement.

An example of a requirement could be: "W*here a member has not made a contribution for Y months or their contributions are less than X over that period and their account balance is less than $Z, then they will be written to and advised that their insurance cover will be terminated unless they elect to the contrary within 90 days*."

The above process will be subject to communication requirements in advance and following the cessation of cover to allow the member to opt out of the cessation or reinstate their cover should they wish to do so.

This communication would include the consequences of continuing insurance cover, including but not limited to, the impact of premiums on their retirement savings, and outline the options available to them. This provides an opportunity for members to consider whether they should consolidate their superannuation and whether they should cancel or consolidate their insurance cover.

One of the consequences of stopping cover where members have not responded to the communication is the loss of valuable benefits, which is often only felt at the time of claim. This detriment needs to be considered when compared to the benefits to the broader membership who may never claim.

Recommencement

Consistent with the above, the Code would consider the basis on which cover can recommence in a number of scenarios:

- if a member actively requests the reinstatement of their cover after it has been cancelled
- recommencement if there is an inadvertent delay in a contribution being received
- if a member resumes contributions due to commencement of employment with a new employer
- if a member has casual employment or varying working hours that mean that some months they do not receive SG contributions

[9] ATO – types of unclaimed super 2016.

Broadly, we would anticipate that recommencement rules would mirror commencement rules. A Code could be prescriptive, noting for example that for scenarios 1 and 2, if this occurs within X months that cover will continue and if it occurs within Y months, or in the case of Scenario 3 and 4 cover can be reinstated consistent with the new member process. Outside of this, cover will be subject to underwriting or other risk controls.

It is noted that government co-contributions would not be deemed to be contributions for these purposes.

Because extended contribution inactivity can mean a member is no longer working or has directed future SG contributions to another fund, an extended period of inactivity could be used as a trigger to initiate communication with members.

This communication would include the consequences of continuing insurance cover, including but not limited to, the impact of premiums on their retirement savings, and outline the options available to them. This provides an opportunity for members to consider whether they should consolidate their superannuation and whether they should cancel or consolidate their insurance cover.

This period of inactivity could also be used as a trigger to stop insurance cover if there is no response from the member. One of the consequences of stopping cover where members have not responded to the communication is the loss of valuable benefits, which is often only felt at the time of claim. This detriment needs to be considered when compared to the benefits to the broader membership who may never claim.

B. 3 Feedback questions

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

14. Should a Code prescribe cover cessation thresholds?
15. Do you have view as to what the thresholds should be?
16. Should there be one set of thresholds or should there be a small number allowing for different occupational / age groups?
17. What maximum period of inactivity is most suitable to commence communicating with inactive members – 3 months, 6 months or 12 months, other?
18. 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?
19. 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?
20. Should a mandatory cessation clause only apply to income protection cover, to mitigate against the impact of income offsets?
21. What flexibility is needed to cater for different demographics e.g. members who have casual employment patterns?

Establish an industry standard for recommencement of cover.

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

B.4 Duplicate income protection claims protocols

Because income protection policies include offset provisions which reduce the benefit amount payable after taking into account income from other sources, informal protocols have existed between insurers setting out how benefits are to be treated where members have multiple income protection policies. Members with multiple Death & TPD policies do not have the same issue, as the member, or their beneficiaries, is generally eligible to receive multiple benefits upon claim. Typically these protocols require the claim to be assessed according to the order in which they are notified, unless a member would be materially better off under a policy where the claim is later notified. This is typically managed on a case by case basis.

Formalising these protocols would provide greater certainty to members, superannuation funds and insurers and reduce the back and forth between all parties. This is likely to lead to improved member experience during the claims process and faster average claims assessment times.

It is proposed that these protocols would include determining the priority of payment under these policies, where they are substantially similar, based on when it was notified to the insurer, unless later notified policies provide a material benefit to the member, for example the policy has a longer benefit period, a shorter waiting period before benefits can be paid or a higher income replacement ratio. The intent is to provide the best financial outcome for members.

Developing these protocols is also a pre-requisite for any industry standard for premium refunds if income protection benefits are being offset by other automatic insurance cover.

B. 4 Feedback questions

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

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

B.5 Premium refunds

Where members have accumulated multiple income protection policies, it is likely that some or all of the benefit amounts will be reduced due to offset provisions when a member is on claim. In conjunction with formalising protocols for the treatment of multiple income protection policies, insurers and superannuation funds should develop an industry standard that provides a premium refund for any automatic income protection cover which could be offset against other automatic income protection cover.

It is proposed that this standard applies to automatic insurance members with multiple instances of automatic insurance cover. However it could be extended to include those with cover through industrial agreements or those who acquire cover through advised or direct channels.

A refund could seek to return the member to a similar financial position as if the duplicate cover had not been created. The maximum refund period could be aligned with any proposed mandatory cessation clause where there is an extended period of no contributions.

B. 5 Feedback questions

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

28. 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?
29. How would insurers of these other policies be covered by industry standards?
30. 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?
31. What administrative impacts will this create for superannuation funds and insurers?
32. How would this be applied to existing automatic IP policies, noting that these may extend back from many years?
33. Is a transition period needed, and if so, how long?

B.6 Transition considerations

The proposed solutions will require an appropriate transition period and consideration of grandfathering provisions to allow superannuation funds and insurers to develop capability. In addition, to minimise impacts to the broader membership, changes to policy terms and conditions may need to be undertaken at the next scheduled review of insurance arrangements or at the expiry of any rate guarantee period.

To determine the appropriate premium thresholds, several important considerations will need to be factored in to the proposals. These include:

Future insurability - the option to support the re-introduction of automatic insurance for younger members who opt-out of insurance that is provided under MySuper, and the ability to opt-in for insurance or have auto-reinstatement at a future date without full underwriting.

Premium impacts - the proposal to refund premiums to members where their benefit is reduced because they make a claim under multiple policies will have a cost impact to insurers. While the level of claims paid won't change because of this measure, the net level of premiums collected will reduce once refunds are considered. This may require uplift in premiums for all members to ensure sustainability. Further analysis is required to identify the frequency and quantum of potential refunds will be undertaken during the consultation stage.

SECTION C: FURTHER CONSIDERATIONS

C.1 Improving member decision making

Superannuation decision making, including consideration of their life insurance needs and the need or otherwise for multiple accounts, can be perceived as difficult by members. Superannuation funds, supported by government initiatives such as ASIC's MoneySmart website, could do more to encourage members to consider their insurance cover, including promotion of myGov and the ATO's superannuation consolidation tool.

Examples of where the industry could do more could include embedding a consolidation option within any fund application form, including an explicit authority to undertake a SuperMatch and targeted options to consider how insurance is to be treated. In addition, initiating a welcome call for all new members during which members are encouraged to look for other superannuation accounts using the ATO service or the member authorising the superannuation fund to conduct a SuperMatch search on their behalf. Ongoing consumer education, funded by both industry and Government, is critical in raising this awareness, as is leveraging both the ATO's superannuation database and the implementation of Single Touch Payroll.

Superannuation funds have an existing obligation to take all reasonable steps to identify and consolidate any multiple accounts within the fund (intra fund) and must undertake this on an ongoing basis, at least each financial year. This could be extended to develop protocols for superannuation funds to identify duplicate insurance cover (both intra fund and inter fund) and communicate with members, particularly on joining their fund.

In addition, superannuation funds should adopt a good practice approach to identify members who may hold multiple instances of insurance cover. Once identified, superannuation funds should communicate with members to help them make an informed decision about their insurance cover. Members with multiple instances of income protection cover are at heightened risk of being unable to claims benefits under every policy. Funds offering income protection should include information in their communication about the financial implications of holding multiple income protection policies. This may also include development of a key fact sheet, which will be addressed in later discussion papers.

C.1 Feedback questions

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

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

C.2 Suggestions for government

Replace legislated minimum cover amounts

Currently the MySuper legislation requires that MySuper products provide minimum levels of life insurance. It is recommended that the removal of that requirement is sought, noting the above proposals will place a more holistic obligation on superannuation funds. In executing these obligations, superannuation funds may determine that they want to offer low or no life insurance to members of a particular demographic. For example, a superannuation fund may know that an employer may have a separate group insurance arrangement for its employees and therefore additional insurance for those members is not appropriate. Todays' legislative environment does not support this.

Leverage SuperStream, Single Touch Payroll and the ATO's database

Typically, superannuation funds do not know when their members cease employment with a participating employer. Proxies, such as extended periods of inactivity are used in place of a confirmation of termination but this information is dated and of limited benefit. Where members have changed employers, many will accumulate a new account with their new employers default superannuation fund. As a MySuper member, they will receive automatic Death & TPD cover with the new fund.

Requiring employers to use SuperStream to notify superannuation funds of employment termination could provide a communication trigger for the fund. It is proposed that employers must advise superannuation funds at the earlier of their next superannuation contribution file or 30 days after the employee terminates.

The ATO is also driving a number of other initiatives which could be leveraged to reduce the number of new members with multiple instances of automatic insurance cover. These initiatives include Single Touch Payroll commencing 1 July 2017and the Member information eXchange (MiX) project which is intended to deliver real time reporting of member account attributes when it is implemented in late 2017.

The SuperStream Working Group initiated through Treasury had proposed a new process for enrolment for new employees in the superannuation system, leveraging real time technology to determine whether members had existing superannuation accounts using their TFN for matching purposes. Possible extension to the current STP design could include visibility for members of their existing accounts, including insurance cover or triggered communication to members showing their superannuation and insurance holdings when commencing with a new employer.

Similarly, a lack of awareness with superannuation and insurance combined with low visibility is a critical driver of members holding multiple superannuation accounts and insurance cover. The ATO collects information about members' superannuation holdings, linked by their TFN. This database includes a flag which identifies accounts that hold insurance. Currently members must seek out this information on their own. Funds can also use the SuperMatch service to identify members with multiple accounts, provided individual and specific consent is held. Superannuation funds could deliver more targeted and personalised communication by leveraging this information if it was readily available.

One option is for funds to be permitted to use the SuperMatch service without member consent, but with appropriate disclosures being made. A search could then be done for each new member, solely for the purpose of communicating with and assisting them to make appropriate choices about their superannuation, including any accumulated insurance cover. Legislative change may be required to enable superannuation funds to use SuperMatch in this way.

Leveraging what is being delivered, and seeking to expand the scope of these initiatives, is expected to have a material impact in reducing the number of members for whom multiple instances of automatic cover is created. This is critical in complementing industry action which will largely tackle the issue for members who already have multiple instances of insurance cover.

C.2 Feedback questions

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

38. Is the proposed timeframe in which employers must notify superannuation funds reasonable? Why?
39. What flexibility is required for irregular work patterns, e.g. casual employment, to avoid unnecessary reporting?
40. Should superannuation funds be required to communicate with members once they become aware that employment has terminated?
41. 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?
42. Are there any other initiatives that could be explored to identify members with multiple instances of automatic insurance cover?
43. What else can be done to increase visibility and usage of myGov by members?
44. Should the ATO communicate with members or with members' superannuation funds when it identifies that multiple accounts have been established?
45. How could annual tax related activities such as myTax and tax assessment notices, be leveraged to raise awareness of a member's multiple accounts
46. 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?

Enhanced regulatory guidance on the provision of advice

For many members, superannuation funds are the only source of advice in relation to their superannuation and insurance needs. Superannuation funds undertake many activities to educate and inform members about their superannuation and insurance, including providing factual information, general and personal advice.

Current regulatory guidance may hinder superannuation funds from providing the best support to members when they are considering their insurance needs.

Updated guidance which supports members to make informed decisions, without the need for personal advice could assist members to combat the issues relating to insurance premiums eroding account balances.

C.3 Feedback questions

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

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

SECTION D: OBSERVATIONS AND CONCLUSIONS

Superannuation funds should use the recent focus on the life insurance industry as a prompt to assess the insurance that is provided to members of their fund(s). When they are setting automatic insurance coverage, they need to ensure that is relevant to their own membership demographic and not unduly eroding retirement savings.

Many superannuation funds are already operating to a high standard, and many members of funds have reaped the benefits of the automatic coverage that is provided. This is an important point that should not be lost in the review of these arrangements.

Superannuation funds operate in a highly regulated environment, and the current desire to improve the way in which insurance coverage is set does not necessarily point to any failing in the regulatory framework.

Most of the principles that are proposed in this paper are open to the superannuation and insurance industry to make without any change to the legislation and regulations that govern the industry.

It is important to ensure that any principles that are being suggested are not designed to remove the important of insurance in superannuation and the need for superannuation funds to continue to provide cover that is of value to its members.

Addressing the issue of members with multiple instances of automatic insurance cover requires industry action to minimise the instances of this occurring, proactive steps to help members make informed decisions about their insurance cover when it does occur, and support to reduce the financial impact to members through payment of premiums for cover they may not be able to claim against.

This issue can only be addressed by collaboration between superannuation funds and insurers and with government and a multi-faceted approach is needed to reduce the numbers of both current and future superannuation fund members who are impacted.

The proposed solutions address the underlying drivers of this issue and represent a package of solutions intended to:

- minimise new instances of multiple automatic insurance cover being created
- identify and assist affected members to make informed decisions about their insurance cover
- minimise the financial impact on retirement savings for members of superannuation funds that have automatic insurance.

E. List of Consultation Questions

We invite you to comment on the key questions that have been raised. All submissions will be treated as public documents unless you specifically request that we treat the whole or part of your submission as confidential.

B.1 Questions

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?

   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?
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?
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?

B.2 Questions

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?

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? Upon the expiry of premium guarantee periods? Every three years? Whenever prices or automatic insurance levels are changed?
13. Should there be one set of maximums or should they differ between different occupational / age groups?

B.3 Questions

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

14. Should a Code prescribe cover cessation thresholds?
15. Do you have view as to what the thresholds should be?
16. Should there be one set of thresholds or should there be a small number allowing for different occupational / age groups?
17. What maximum period of inactivity is most suitable to commence communicating with inactive members – 3 months, 6 months or 12 months, other?
18. 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?
19. 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?
20. Should a mandatory cessation clause only apply to income protection cover, to mitigate against the impact of income offsets?
21. What flexibility is needed to cater for different demographics e.g. members who have casual employment patterns?

Establish an industry standard for recommencement of cover.

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

B.4 Questions

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

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

B.5 Questions

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

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33. Is a transition period needed, and if so, how long?

C.1 Questions

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

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

General questions

49. How effective will the proposed solutions be?
50. Are there any other solutions?
51. What flexibility should be given to existing benefit designs?
52. What timeframe should be given to transition with this new requirement?
53. What challenges would you have with altering your benefit design?
54. What are the potential unintended consequences?

We want your feedback

We invite you to comment on the key questions that have been raised. All submissions on this discussion paper are due by **7 April 2017** and should be sent to the Project Managers Office at:

ISWG-PMO@kpmg.com.au

All submissions will be treated as public documents unless you specifically request that we treat the whole or part of your submission as confidential.