MySuper consultation working group

Issues paper on Insurance

March 2011

PROPOSED REFORMS AND OBJECTIVES

New arrangements for the selection and management of the external insurance cover procured by trustees, and for the default insurance offered to members, have been announced as part of the Government's the Stronger Super package of reforms.

The reforms aim to provide all members of APRA-regulated funds with adequate default insurance for total and permanent disability or premature death, but allow members the freedom to choose their own insurance cover if they wish. In addition, the reforms seek to ensure that trustees strike the right balance between the objectives of providing adequate default insurance and maximising the retirement benefits of members.

The new arrangements will require trustees to offer default opt-out life and TPD insurance to all members in MySuper and choice products (with limited exceptions) (response to recommendations 5.1 and 5.6). In addition, income protection insurance (sometimes known as income continuance or temporary disability insurance) will be allowed to be offered by a trustee on an opt-out basis (response to recommendation 5.9). Other types of insurance do not support the objectives of superannuation and will not be permitted to be offered by any superannuation entity and trustees will have to phase out these types of insurance for existing members (response to recommendation 5.10).

Trustees will have a separate statutory duty to manage their insurance offerings in the best interests of members, including:

- selecting insurance cover with regard to the cost and value for money for members;
- negotiating the terms of the insurance contract, including adequacy of the level of default cover; and
- pursuing claims that the insurer has denied in part or total where there is a reasonable expectation of success (response to recommendation 5.3).

This duty will be supported by a new requirement for trustees to devise and implement an insurance strategy including the default coverage and, if allowed, optional coverage that will be offered to members (response to recommendation 5.4).

A single default insurance offering will apply to all members in a MySuper product. The default offering will be able to vary the levels of cover and/or the cost of premium on the basis of age, gender and occupation type. Trustees will not be able to tailor their default insurance offerings to any sub-set of MySuper members.

Finally, superannuation funds will not be permitted to self-insure any insurance benefits except for the grandfathering of existing self-insurance for defined benefit members in defined benefit funds (or sub-plans) that are currently allowed to self-insure (response to recommendation 5.16).

Other insurance measures announced by the Government in the Stronger Super package relating to recommendations on time limits for review by the SCT (recommendation 5.7), and binding death benefit nominations (recommendations 5.14 and 5.15) will be considered by the Governance working group. Recommendation 5.11 will be discussed as part of a paper on disclosure and recommendations 5.12 and 5.13 relating to the payment of commissions on insured member benefits will be considered as part of a paper on advice.

ISSUES

Issue 1 – Opt-out insurance

Trustees will be required to offer life and TPD insurance to members in MySuper and choice products on an opt-out basis (response to recommendations 5.1 and 5.6). Requiring trustees to offer life and TPD insurance establishes a safety net for members and their dependents to help meet the costs associated with premature death or total and permanent disablement of the member. Offering life and TPD insurance on an opt-out basis also means that there cannot be any compulsory insurance. A member will be allowed to fully opt-out (at any time) and have no insurance associated with their account. This will ensure that members with insurance cover outside of superannuation do not need to have their retirement savings diminished by the costs of compulsory insurance.

There will be a limited exception from the requirement to offer life and TPD insurance for funds that are unable to obtain coverage from an external insurer or where the trustee attests that coverage can only be obtained for unreasonably expensive premiums.

Income protection insurance can assist members to be able to continue contributing to superannuation by helping meet the costs of finding new employment, or replacing income for a temporary absence from the workforce. Further, it will usually provide benefits to members in the long period that it can take to be assessed for TPD benefits. Therefore, income protection insurance should be available to members through their MySuper product (response to recommendation 5.9).

However, income protection insurance has characteristics that may mean it is of minimal value to certain members, for example if they have sufficient work based leave arrangements or are not employed. Income protection insurance can also be expensive, and the cost of premiums detracts from retirement savings. Therefore, it may not be suited to all members of a fund and consequently may not be suitable for the default insurance offering.

One risk of requiring a default insurance offering is that many members may be unaware that they will be able to opt-out of insurance cover, and in some cases, will not even be aware that they hold insurance through their superannuation. Under these new arrangements there may be a case for enhanced disclosure requirements for insurance. In particular, such disclosure should inform members of their ability to opt-out of insurance, given the potential impact of premiums on accumulated retirement savings.

Members that choose to opt back in to insurance cover, after opting-out, may also be unaware that they may have to meet conditions they did not have to meet previously, such as medical checks. Therefore, it may also be appropriate for members to be informed about any conditions for opting back into insurance cover.

Finally, there is an existing requirement in the *Superannuation Guarantee (Administration) Regulations 1993* that trustees must offer a minimum level of insurance in respect of death. Under the current regulations, the member must simply have the option of taking out life insurance of the amount specified by the Regulations. The SSR panel recommended in recommendation 5.2 that the Government repeal the minimum levels of life insurance but this was not supported by the Government in its response.

This means that under the new arrangements, all funds will have to offer at least a minimum level of life insurance (on an opt-out basis) as specified in Regulations. However, trustees may choose to set default insurance offerings above the legislated minimum levels where they conclude this is in the best interests of members. In respect of TPD insurance, it will be up to the trustee to determine the appropriate level of TPD cover to be offered, consistent with the obligation to offer insurance in the best interests of members.

Funds can currently offer compulsory insurance cover or opt-in cover only. Therefore, these new arrangements may require funds to renegotiate their insurance contracts.

Question 1.1 Are there any impediments to allowing any member of a fund to fully opt-out of insurance at any time? Are there issues with members being able to subsequently opt-into insurance after having opted-out?

Question 1.2 Is it likely that any trustee of a MySuper product will not be able to obtain life and TPD insurance and will require an exception?

Question 1.3 On what basis should income protection insurance be offered to members?

Question 1.4 Should trustees be required to inform new members (separately from the PDS) on how to opt-out or vary their insurance coverage when they join the fund?

Question 1.5 What information should trustees be required to provide about opting back into insurance?

Question 1.6 Will contracts with insurers have to be renegotiated? How long will be required to phase in any changes to contractual arrangements?

Issue 2 – Types of insurance

Trustees will be required to offer life and TPD insurance on an opt-out basis and will also be allowed to offer income protection insurance on an opt-out basis (response to recommendations 5.1, 5.6 and 5.9). These types of insurance support the objectives of superannuation by providing benefits to a member's beneficiaries when the member dies or by providing benefits when a member is permanently or temporarily unable to work due to injury or ill-health. These benefits contribute to the standard of living of a member and their dependents when they cannot work, or assist the member to return to work to continue to contribute to their superannuation.

Apart from life, TPD and income protection insurance, no other type of insurance (for example, trauma insurance) supports the objectives of superannuation. Therefore, these will not be permitted to be provided to members through their superannuation and any existing policies outside those categories should be phased out (response to recommendation 5.10).

The types of insurance able to be offered under a trust deed will be listed and defined by legislation. These definitions would be incorporated in a regulatory approval of an ancillary purpose under the sole purpose test in section 62 of the SIS Act or in a prudential standard. Ideally, these definitions should only specify those minimum 'features' of the insurance that will ensure that it is consistent with the objectives of superannuation.

The definitions could cover the following:

- Life insurance must only provide benefits on death of a member (or the member having met requirements to certify that they have a terminal medical condition).

- TPD insurance must only provide benefits where the member, because of ill-health (whether physical or mental), is unable to engage in gainful employment for which the member is reasonably qualified by education, training or experience.

- Income protection insurance must only provide benefits as a non commutable income stream for a period not exceeding the period of incapacity from employment of the kind engaged in immediately before the temporary incapacity.

For the avoidance of doubt, the payment of benefits would have to be consistent with the payment standards contained in part 6 of the *Superannuation Industry (Supervision) Regulations 1994*. Life and TPD insurance benefits will be able to be paid to the member in either a lump sum or in a pension-style benefit that pays instalments over time.

The definition of life insurance aims to accommodate cover where the benefit is payable in advance of the death of the member in situations where they are able to demonstrate they have a terminal medical condition. This is effectively the same type of insurance, but provides for the timing of the benefits to be moved forward.

The definition of TPD insurance is modelled on the condition of release for permanent incapacity contained in the *Superannuation Industry (Supervision) Regulations 1994,* and the definition of tax deductibility in the *Income Tax Assessment Act 1997*. This should ensure that superannuation funds will only be able to offer insurance for which the premiums are tax deductible and the benefits of the insurance policy can be released to the member.

Similarly, the definition of income protection insurance is modelled on the conditions of release contained in the *Superannuation Industry (Supervision) Regulations 1994.* It is intended that the definition means that benefits must simply assist the member to rehabilitate and return to work. Benefits must not continue to be provided while the member is working in any capacity, or is eligible for TPD benefits.

Question 2.1 Are the definitions above appropriate to ensure that insurance offered by trustees supports the objectives of superannuation?

Question 2.2 Besides death, TPD and income protection insurance are other types of insurance currently offered? If so, what are the issues with making any changes to existing contractual arrangements or trust deeds required to phase out this insurance? What transitional period would be required to allow contracts to expire or be renegotiated?

Issue 3 – Additional insurance within MySuper

The need for insurance coverage changes over the course of a member's life and is dependent on a range of individual factors. The ability to opt for additional insurance (ie, above the default level of cover) would provide members the flexibility to vary their insurance coverage as their needs change without having to forgo the benefits of MySuper.

Question 3.1 Should trustees be able to offer optional additional insurance in their MySuper product and, if so, under what circumstances and with what conditions?

Issue 4 – Default insurance offering and Insurance strategy

All trustees will have a new statutory duty to manage their insurance to benefit members and trustees of large APRA regulated funds (including those funds offering a MySuper product) should have an insurance strategy (response to recommendations 5.3, 5.4 and 5.5).

Trustees of MySuper products will have to develop a single default insurance offering that applies to all members of the product. The default offering would be able to vary the levels of cover and/or the cost of premium on the basis of age, gender and occupation type. The default offering for MySuper members may comprise part of the fund's overall insurance strategy.

Currently, there are two dominant approaches to designing insurance coverage at the product-level. First, where insurance is offered on the basis of a fixed premium for all members, the level of insured cover typically varies depending on relevant factors such as age and gender (but may also include occupation type). Second, under a life staging approach, the trustee sets the cover appropriate to members of the fund based on their age, gender and occupation and the premium varies for each member accordingly. This is often charged to members in units of $1,000 of cover, and members can purchase or reduce their units of coverage. Both of these approaches could be appropriate depending on the membership of the MySuper product.

Currently the SIS Act specifies that trustees of superannuation funds must formulate an investment strategy for the benefit of all members of the funds. In doing this, trustees must have regard to key principles in formulating this strategy.

In a similar way, trustees will now be required to formulate an insurance strategy having regard to certain principles. APRA will develop a prudential standard supported by providing appropriate guidance material on the development of an insurance strategy.

Question 4.1 Do trustees currently develop insurance strategies and if so, what does the strategy consider?

Question 4.2 Are there reasons why the insurance strategy (or a summary of it) should not be publicly disclosed?

Issue 5 – Self-insurance

Self-insurance creates risks for the ability of all APRA-regulated funds to meet member claims and the Government considers that it should generally not be permitted for either MySuper or choice products (response to recommendation 5.16).

There are significant risks associated with self-insurance as it is not subject to the same prudential requirements of life insurance companies. Therefore, funds that currently self-insure will have to transition to external insurance. A limited exception will be allowed for grandfathering existing self insurance in respect to defined benefit members in defined benefit funds (or sub-funds) that are currently allowed to self-insure by APRA.

This transition may require existing reserves held for insurance purposes to be returned to member accounts or possibly used to fund future premiums. Both of these approaches entail member equity issues.

There may also be a need for trustees to make changes to their trust deeds to avoid the possibility that members of the fund continue to bear the majority of the risks where, for example, the definition of TPD under the trustee's insurance contract is limited to when a member can no longer work in any occupation for which they are suited by training, skills or experience but this gives benefits in a narrower range of circumstances than if the member was entitled under the trust deed definition to benefits when they can no longer work in their own occupation. It may not always be easy for a trustee to obtain replacement cover which matches the current cover provided by the trust deed.

Question 5.1 What impediments exist to the transition of funds that currently self-insure to externally provided insurance?

Question 5.2 Is there a risk of a potential mismatch between cover established in a trust deed and replacement external insurance? How is this best addressed?