

Submission to the Treasury Financial Services Reform Taskforce

Legislating Universal Definitions, Terms and Exclusions in MySuper Products

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1. Introduction

Commissioner Hayne, in the Final Report of the Financial Services Royal Commission (FSRC), characterised life insurance in superannuation as “a means of spreading risk [which] brings significant benefits for both individuals and for communities.”

He noted that most members were not engaged with their superannuation and insurance entitlements and the default arrangements introduced under MySuper in 2014 had become “a significant feature of the Australian superannuation system”

However, he stated that some changes were needed to better balance the rights and obligations of insurers and insureds in the delivery of MySuper products.

We are in hot agreement with all of the above. The question is the what and the how.

Commissioner Hayne looked to the standardisation of policy terms and conditions and the levels of cover as the key markers and has rightly requested a review with an eye on the potential impact any changes may have on premiums, which could in turn affect retirement incomes through account erosion.

It is our view that changes are needed to ensure greater value for money of what is a unique and crucial feature of the Australian retirement incomes system.

2. Background

It may inform Treasury’s considerations by placing group insurance in superannuation in an historical context.

Disability and death benefits are designed to supplement or “top up” the accumulated superannuation accounts of those members whose working lives are cut short because of disability or death, such that they would still have sufficient

retirement incomes-or their families/dependents would have income support following their premature deaths.

The design is consistent with the sole or ancillary purpose test under the *Superannuation Industry (Supervision) Act 1993* (the SIS Act) and has saved Australian taxpayers billions of dollars in financial support for people who would otherwise have been dependent on social welfare.

Historically, government pension schemes and employer-sponsored defined benefit funds included permanent incapacity or death lump sums or pensions, sometimes underwritten by life insurers.

The 1980s heralded the introduction of occupational superannuation with the emergence of not-for-profit industry funds and for-profit retail funds. These funds sought to replicate defined benefit funds by providing life, Total and Permanent Disability (TPD) and income protection insurance benefits provided under group insurance contracts funded by premiums deducted from occupational superannuation contributions or accounts.

The trend was turbocharged with the introduction of compulsory superannuation under the *Superannuation Guarantee (and Administration) Act 1992* with millions of Australian workers obtaining life insurance for the first time.

Regulatory enhancements followed with modest death insurance cover up to \$50,000 mandated with the introduction of Choice of Fund legislation in 2005 and default death and TPD insurance cover and optional income protection insurance cover included as minimum standards for MySuper- compliant funds in 2014.

The end result is that almost all Australian workers have life insurance through employment superannuation.

However, under-insurance remains a problem in Australia. Most superannuation fund members have relatively modest levels of default cover, in large part due to a lack of engagement and financial literacy.

Insurance premiums purchased at wholesale rates under group policies were a modest impost until approximately 6 years ago when rising claims and high loss ratios led to a spike in premiums. This resulted in some excessive account erosion, a tightening of claims management and the introduction of narrower definitions and eligibility.

It is in the above context that the FSRC made Recommendation 4.13 to charge Treasury with determining the practicability and affordability of legislating for key definitions, terms and exclusions in default MySuper group life policies.

3.Issues for Determination

3.1 The merits of setting standard terms and conditions

The policy setting behind having standard terms and conditions in a contract is essentially a power and knowledge imbalance between the contracting parties justifying a minimum set of terms and conditions reflective of the essential nature of the contract being bargained for.

The need is particularly relevant in insurance contracts. Insurers offer policies on set terms with little or no room to negotiate variations. Consumers, for their part, enter into the bargain with pre-conceived notions of what is being insured and the circumstances under which the policy would respond, often in response to invitations in ad campaigns and glossy brochures.

The policy documents are often dense and consumers find them difficult to navigate and understand, let alone negotiate specific terms and conditions.

The need for standard terms and conditions in insurance contracts was recognised as far back as 1982. The Australian Law Reform Commission Report on Insurance Contracts recommended the adoption of standard cover in five types of general insurance, namely, home and contents, motor vehicle, personal accident and illness, consumer credit and travel insurance.

The Commission stated that there was a “clear need”¹ for standard cover to avoid terms “which affect in unexpected ways the cover offered” and which an insured only becomes aware of at the time of claim.²

The Commission did not recommend the extension of standard cover to life insurance contracts. However, they were careful to stress that the limited scope “should not be taken to indicate a judgment that standard cover would be inappropriate in other contexts”³ and that the possibility of applying the principle to other areas “remains open”.⁴

The *Insurance Contracts Act* 1984 (the IC Act) implemented the recommendations and incorporated the draft standard terms and conditions of the five types of general insurance in the *Insurance Contracts Regulations* 1985 (the IC Regulations).

The problems of consumers reading and understanding life insurance contracts have been and remain no less apparent than for the prescribed general insurance contracts. In fact, the potential for disengagement is greater in a setting where superannuation fund members do not bargain for the policy terms and conditions (at least initially) and are not provided with policy documents.

Whilst professional trustees could and should have a more nuanced understanding of life insurance, they have obligations to their membership as a whole, including price pressures.

¹ Australian Law Reform Commission Report on Insurance Contracts (1982) ALRC 20 at p44.

² Ibid.

³ Ibid at p51.

⁴ Ibid.

Accordingly, we submit that it would be opportune and indeed long overdue to extend standard cover under Section 35 of the IC Act to life insurance. While standard cover currently only applies to individual insurance contracts, it could be extended to group policies by amendment to the IC Act. The current formula to deviate from standard cover could be maintained for superannuation fund members applying for additional cover or seeking to opt out of non-mandatory standard terms and conditions.

We would suggest that a working group consisting of insurance company, superannuation fund and consumer representatives should design a group life insurance standard terms and conditions document for inclusion in the IC Regulations.

3.2 Total and Permanent Disability (TPD)

Whilst there are variations in the definition of TPD under group insurance contracts held by superannuation funds, it is our view that any TPD insurance benefit under a MySuper product that is inconsistent with the “permanent incapacity” definition under the *Superannuation Industry (Supervision) Regulations 1994* (the SIS Regulations) is contrary to law.

Regulation 4.07D requires that an insurance benefit in superannuation must be consistent with a condition of release i.e. in the case of a TPD insurance benefit, the definition must at least satisfy the “permanent incapacity” condition of release as defined in Regulation 1.03C. Accordingly, wording can be less generous than that in Regulation 1.03C because the benefit paid by the insurer to the trustee would comfortably satisfy the permanent incapacity early release requirement.

However, in relation to MySuper products, the “permanent incapacity” insurance benefit that must be provided under section 68AA (1) of the SIS Act can only be a benefit payable if the superannuation fund member is permanently incapacitated as defined in Regulation 1.03C.⁵

Section 68AA (3) allows a trustee to obtain an insurance policy with a permanent incapacity benefit subject to more restrictive eligibility conditions (eg an “at work” test) but they cannot offer the benefit with a definition inconsistent with the permanent incapacity definition under Regulation 1.03C.

Accordingly, it is our view that the permanent incapacity definition which could be characterised as the standard “suitable occupation” definition with a comparatively generous “unlikely” test is already prescribed by legislation for all MySuper products.

In practice, a significant number of MySuper TPD definitions deviate from this permanent incapacity definition and in some cases adopt a much narrower definition, which is of concern.

⁵ Australian Law Reform Commission Report on Insurance Contracts (1982) ALRC 20 at p44.

Nevertheless, to the extent that there is any doubt, we believe that a standard and mandatory TPD definition should be in place for MySuper products to provide certainty and to ensure that a TPD insurance benefit is consistent with retirement incomes policy and value for money for superannuation fund members.

3.3 Other terms, definitions and exclusions

For the same reasons, we believe that other terms and conditions that commonly appear in group life contracts should be standardised.

These could include:

- other standard definitions of disability eg. total disability
- eligibility requirements
- exclusions from cover
- limitations on benefits
- offset clauses
- claims requirements

There is a balance to be struck between certainty and flexibility and it would be important to foster and not stymie market competition and innovation. However, in our submission, the case for some standardisation to bring the life insurance industry in line with other financial services industries and to restore public confidence is overwhelming.

4. Questions for Discussion

1. What are the costs and benefits of standardisation of terms and definitions for default MySuper group life policies?

As detailed above, the benefits of standardisation are:

- Certainty;
- Consumer protection from unfair terms and zombie policies;
- Consumer protection for commonly understood minimum terms and definitions;
- Ensuring consistency with retirement incomes policy and the sole/ancillary purpose test;
- Enhancing affordability and value for money of insurance in superannuation;
- Providing measurable benchmarks;
- Promoting plain English documents in an easy-to-read format.

The potential costs could be in higher premiums if standard terms and definitions are more generous than they should otherwise be. However, standard terms and definitions which strike a balance between the commercial interests of insurers

with consumers' rights to products they reasonably thought they had bargained for will promote affordability and value for money without unreasonably eroding account balances.

To promote this, it would be important that standard terms and definitions are developed with an emphasis on minimum standards and to avoid aspirational or overly generous terms.

As mentioned above, standard terms and definitions may contraindicate innovation which could affect competition and ultimately drive up premiums. However, if the standard terms and definitions are constructed carefully and within the conservative lens above, insurers would still have room to innovate and compete for market share.

In this regard, it is relevant to consider the experience of the general insurance industry after the introduction of standard cover under the IC Act. It is submitted that general insurers have not been hamstrung by standard cover and in the last 33 years have maintained a healthy level of competition.

2. What terms and definitions would benefit from standardisation? Are there particular terms/definitions where the case for standardisation is stronger or should be prioritised?

The group life definition that has received the most attention, both publicly and in the FSRC report is Total and Permanent Disability or TPD.

TPD insurance benefits in superannuation are designed to replace superannuation contributions forgone following a premature exit from the paid workforce because of disability thereby ensuring that a member would still have an adequate retirement income.

The SIS Act and the *Income Tax Assessment Act 1936* reflected this policy setting in rules around the ancillary purpose test, early access to preserved superannuation and the taxation of invalidity benefits.

The standard measure was a permanent incapacity definition that a member's ill-health (whether physical or mental) made it unlikely that he/she would engage in gainful employment for which the member was reasonably qualified by education, training or experience.

However, over the years, the definition has varied and in recent years has narrowed such that members who would otherwise satisfy the statutory definition of permanent incapacity are not eligible for TPD insurance benefits under the relevant group life policies provided through their employment superannuation funds.

The FSRC noted the comparatively high level of rejected claims for TPD compared with other benefits and identified a particular need for greater certainty.

Given the shift away from the legislative permanent incapacity definition and given the prominence of TPD benefits in the Australian superannuation system, a standardised definition of TPD is a key priority.

The other definition worthy of consideration is that for total disability which is relevant to income protection or temporary disability benefits.

MySuper-compliant funds may offer income protection insurance cover as a default option, although this is not mandatory. Benefits must be paid as an income stream for the period a member has temporarily ceased work due to physical or mental ill-health that does not constitute permanent incapacity.

The size and availability of income protection insurance benefits within superannuation has increased over the years, particularly since trustees of superannuation funds were able to claim tax deductions for income protection cover with benefit periods beyond two years from 28 March 2007.⁶

The definitions of total disability have varied from the standard incapacity to perform the usual occupation, with some definitions more generous and others more onerous. At the same time, the loss ratios of income protection insurance in group insurance through superannuation have been high and arguably unsustainable.⁷

Given the above, consideration should also be given to setting a standard definition of total disability.

Related to the above, are group life policy terms that have created uncertainty and problems with claims and allegations of unfair terms and 'zombie' policies. These include:

- eligibility requirements such as 'at work' or 'active employment' tests or permanent versus casual employment requirements, which may disenfranchise significant cohorts of fund members;
- offset clauses, particularly for other TPD or income protection benefits or Centrelink benefits, which may render cover worthless;
- pre-existing condition, suicide, intentional act or mental health exclusions which may limit or act to deny claims, depending on how broadly they are worded.

All such terms run counter to the traditional automatic acceptance feature of group life insurance. Whilst they may be legitimate from a commercial and affordability perspective, standardisation at least on a default basis should, in our submission, be considered.

⁶ ATO TD Ruling 98/27.

⁷ APRA Quarterly Life Insurance Performance Statistics, September 2018 & December 2018 Quarters, and the Productivity Commission Inquiry "Superannuation: Assessing Efficiency and Competitiveness" Report December 2018, Overview at p20.

3a. Should trustees be permitted to offer TPD insurances that differ from the definition of permanent incapacity in the SIS Act?

As detailed above, it is our view that currently a MySuper TPD insurance benefit must not differ from the “permanent incapacity” definition in Regulation 1.03C, whilst other superannuation products are permitted to offer TPD insurance benefits with definitions which are narrower than Regulation 1.03C.

The question asked is whether some flexibility should be afforded to trustees of MySuper products.

The previous practice of superannuation funds offering generous “own occupation” TPD benefits was banned as part of the Stronger Super reforms in 2013. However, a number of funds, including those offering MySuper products, have in practice offered TPD benefits with definitions narrower than the standard ‘suitable occupation’ permanent incapacity definition.

These include:

- ‘suitable occupation’ definitions with an ‘unable ever’ test;
- ‘suitable occupation’ definitions with a retraining clause;
- ‘activities of daily living’ (ADL definition) - which often apply to members classified in high-risk occupations;
- ‘any occupation’ definitions.

All the above definitions satisfy the early release requirements for permanent incapacity under the SIS Regulations. However, the ADL definition in particular has deviated so far from the standard suitable occupation definition as to bear little or no relationship to the objective of TPD insurance benefits to top up retirement incomes.

Only a handful of superannuation fund members whose working lives are cut short because of injury/illness would ever satisfy the ADL requirements that they be unable to perform basic human activities such as eating, bathing, dressing, toileting and transferring to bed/chair.

Most superannuation fund members are unaware of the differences in policy definitions and have little or no aptitude for identifying whether they are defaulted into a harsher ADL definition because of a risk classification.

Whilst trustees could and should know better, it is apparent that some TPD insurance benefits, including in MySuper products, are not fit for purpose or value for money.

MySuper products are designed to provide low-cost and simple superannuation benefits, including default life and TPD insurance benefits.

The shift by some superannuation funds to default members deemed to be in high-risk occupations into ADL definitions for TPD benefits has disenfranchised many from permanent incapacity benefits, usually without any premium differentiation.

This has led to significant problems and distress at claims stage and has affected the integrity of MySuper.

Accordingly, we submit that the integrity of the current legislative framework with its mandatory permanent incapacity TPD definition must be maintained and indeed strengthened to ensure compliance.

Trustees will still have the flexibility to negotiate contracts with eligibility conditions to deal with affordability issues, as currently allowed under Section 68AA (3) of the SIS Act. However, it is our view that given the problems with some alternative definitions and compliance, a single standard and mandatory TPD definition is justified.

3b. Is the current legislated definition of permanent incapacity an appropriate standard definition of TPD?

The Productivity Commission in its final report on “Superannuation: Assessing Efficiency and Competitiveness” noted that the objective of TPD insurance benefits in superannuation was “to insure[s] against the risk that a member’s accumulation phase is cut short”.⁸

The current permanent incapacity definition requires that a member must be unlikely to engage in gainful employment given his/her current education, training or experience.

The question is whether this ‘suitable occupation’ definition with an ‘unlikely’ test is a sufficient measure of a member’s accumulation phase work being cut short.

The definition is basically the same as that which existed for decades under government defined benefit schemes for permanent incapacity pensions before the advent of compulsory employment superannuation under the SIS Act.

It requires an assessment of the likelihood of a claimant returning to the paid workforce (and thereby resuming the accumulation of superannuation) by examining not only their usual occupation but also any other suitable work given their transferable skills.

The definition has been subject to judicial consideration over the years, including as to a capacity for work requiring more than de minimus retraining. A number of the decisions have found a claimant to be TPD despite returning to some regular work after retraining.⁹

⁸ Productivity Commission Inquiry “Superannuation: Assessing Efficiency and Competitiveness” Report December 2018, at p364.

⁹ See *Halloran v Harwood Nominees Pty Ltd & Anor* (2007) NSWSC 913).

Such outcomes have chipped away at the objective of insurance in superannuation at the margins and have led to some criticisms about affordability and claimants returning to work after a benefit is paid.¹⁰

Affordability has become an issue for insurance in superannuation in the last 5 years with adverse claims experiences leading to premium rises by an average of 35% in the 3 years to 2016/17.¹¹ This has led to account erosion which has attracted the attention of the Productivity Commission.¹²

There have also been criticisms about the management of TPD claims, which has led to calls for binding and enforceable codes of practice.¹³

Although the identified problems are being dealt with in various forums, it is our view that consideration should be given to amending the TPD definition to add a 'reasonable retraining' clause.

Superannuation funds such as Australian Super, VicSuper and QSuper have renegotiated their group life contracts in the last few years to amend the standard TPD definition to include an incapacity to engage in other gainful employment the member could reasonably be retrained in.

Such clauses remain true to the objective of TPD insurance in superannuation and indeed sharpen the focus on replacing accumulation phase contributions, by excluding payments if a person is likely to return to work in some other occupation they do not currently have the transferable skills to perform and thereby resume the accumulation phase.

The amendment would deal with the issue of people returning to work after a benefit is paid, temper rising claims and help deal with affordability issues.

It would be important that any such retraining clause be subject to a reasonableness test to ensure that the retraining is both within the person's abilities to undertake and reasonably available, without imposing an unreasonable burden.

It should also be accompanied by a limited offer of assistance with the retraining/rehabilitation to ensure it is a practical measure and not purely theoretical.

We submit that a permanent incapacity definition which includes a reasonable retraining clause with limited assistance to be afforded for such retraining/rehabilitation is good policy. It is consistent with the objective of TPD insurance in superannuation as a top up to retirement incomes and yet reduces

¹⁰ Superannuation fund, Sunsuper, has asserted that "In an in-depth study of members who had previously been paid a TPD claim, Sunsuper found that 36% had returned to work or were actively seeking employment" Wanda Britton, Head of Product, Sunsuper, April 2016.

¹¹ Productivity Commission Report December 2018 at p363.

¹² Productivity Commission Report December 2018, Recommendation 16.

¹³ Productivity Commission Report December 2018, Recommendation 17 & FSRC Final Report February 2019, Recommendation 4.9.

the risk that the accumulation phase is cut short by promoting rehabilitation and retraining.

4. Should the definition of TPD allow for rehabilitation or return to work initiatives? Why/why not?

The *Health Insurance Act 1973* prohibits life insurers and general insurers from paying for medical treatment that may otherwise be payable under Medicare or by a private health insurer. This means that life and general insurers cannot pay for most medical services to treat superannuation fund members' injuries/illnesses or to fund many medical-related rehabilitation services.

Insurers can and do offer some limited retraining services, for instance as part of income protection benefits. However, under the SIS Regulations, trustees offering TPD benefits under MySuper products must offer TPD benefits consistent with the permanent incapacity definition-which currently does not include a retraining/rehabilitation clause.

For the reasons set out above, we submit that the standard permanent incapacity definition of default MySuper TPD insurance benefits should include a reasonable retraining clause that should be accompanied by a limited offer to assist with rehabilitation/retraining services.

Prevention and rehabilitation/retraining fit well within the policy setting of insurance benefits in superannuation. They can reduce the incidence and period of incapacity which will in turn enhance the ability of members to work and continue to accrue superannuation for their retirement, whilst providing a safety net for those whose working lives are genuinely cut short.

The initiatives must be modest to limit the cost and reduce account erosion.

The Parliamentary Joint Committee on Corporations and Financial Services (the PJC) conducted an inquiry into greater involvement by private sector life insurers into worker rehabilitation. The PJC's report in October 2018 rejected a proposal for greater involvement put forward by the Financial Services Council (FSC), in part because of the open-ended discretion for life insurers to offer rehabilitation medical treatment.

The PJC was critical of the FSC proposal as having "no equity of access and no accountability"¹⁴ and recommended that ASIC conduct an investigation of in-house rehabilitation services to determine whether concerns about the FSC proposal were resolved.

Whilst we agree with the findings of the PJC, if adequate consumer protections were put in place, these concerns could be allayed.

¹⁴ Parliamentary Joint Committee on Corporations and Financial Services Report "Options for greater involvement by private sector life insurers in worker rehabilitation", October 2018, para 3.104.

A consumer protection framework could include robust and binding codes of practice, unfair insurance contracts legislation and enhanced powers for regulators. This would codify insurers' behaviour towards claimants in offering rehabilitation/retraining services and assessing related TPD claims, and provide oversight, dispute resolution systems and remedies.

Given the poor behaviour identified in the FSRC final report, the above measures should be implemented as a package to ensure the efficiency and value for money of insurance in superannuation.

5. Is there a need for universal insurance exclusions in MySuper products? Why/why not? If yes, should exclusions be standardised across all types of insurance provided within MySuper products? What standardised exclusions would deliver the greatest benefit to consumers?

5.1. Exclusions

We do believe that there is a need for some other standard terms and conditions to be considered, although perhaps not universal exclusions.

Group life policies in superannuation, including for MySuper products, usually provide cover on an automatic acceptance basis, subject only to eligibility conditions around members being 'at work' or in 'active employment' at the time of joining the fund. They also usually do not incorporate any (or many) exclusions for defined events such as suicides, self-inflicted injuries or war-related injuries/illnesses.

Some policies limit or exclude cover for pre-existing injuries/illnesses or specific conditions such as mental illnesses but these are very much the exception, not the rule. In the 1990s, many group insurance policies either excluded HIV/AIDS-related claims or invoked two-year pre-existing condition exclusion clauses; but even these largely disappeared by the early 2000's.

Exclusions operate to limit claims which might otherwise be payable. Unless there is a compelling case that an event or condition must be excluded because it will always offend the objective or affordability of insurance in superannuation, we would submit that there is no basis for imposing any universal exclusions. At best, trustees and insurers should have the flexibility to impose exclusions on a case-by-case basis where a compelling commercial reason exists.

5.2. Eligibility

The same rationale would apply to limitations on benefits and eligibility requirements for cover.

Regarding the latter, we believe the trustees must have some flexibility to negotiate group life policies with some underwriting tools in order to facilitate automatic acceptance cover without individual underwriting on the one hand and to nevertheless ensure affordability without excessive account erosion on the other.

One of the key features of group insurance within superannuation is the ability to spread the risk across the membership and offer automatic acceptance cover without individually underwriting each member and the expense that goes with that.

If the ability to impose general underwriting limits is removed, this may affect the market and risk premium increases.

Nevertheless, there could be a case for standardising relevant definitions such as 'at work' or 'active employment' tests.

There is also a case for defining what constitutes casual or permanent employment and when/if casual employees should be excluded from types of cover. Under some MySuper products, casual employees and those members working upwards of 30 hours per week are either excluded from income protection or perhaps TPD cover or have limited cover.

Although trustees have existing obligations under the SIS Act to formulate, regularly review and give effect to an insurance strategy¹⁵, some limited intervention by way of universal standards may be appropriate and act as a guide to trustees in fulfilling their obligations.

5.3. Income Protection

The other area in which standard terms and conditions in MySuper insurance products should be considered is in the provision of income protection insurance, which is currently optional.

The Productivity Commission, in its December 2018 Report, stated that the link between retirement incomes policy and income protection insurance, was more tenuous than for TPD insurance but does exist to assist workers to re-enter the workforce through facilitated rehabilitation programs and by way of Superannuation Guarantee contributions included with the monthly payments.¹⁶

The Productivity Commission also highlighted what it called zombie policies whereby income protection benefits were wholly/partly offset against other policies or other income support benefits such as via workers compensation or Centrelink.¹⁷

We agree with the above and it is certainly our experience that income protection payments through superannuation funds are often offset. Further, unless they include an ongoing Superannuation Guarantee component (which is by no means universal), members do not accrue any further retirement income which invariably means they become welfare dependent.

Finally, consideration should be given to limiting the benefit period for MySuper income protection insurance policies. Historically two years was the standard benefit period for income protection bundled with TPD insurance. It was seen as a

¹⁵ Section 52(7).

¹⁶ Productivity Commission Report December 2018, p364.

¹⁷ Productivity Commission Report December 2018, Overview at p20.

reasonable period to assess permanency and during which workers may be supported to return to the workforce.

The 2-year benefit period was effectively extended by the ATO Ruling TD 2007/3 which extended the tax deductibility of income protection premiums inside a superannuation fund beyond 2 years. Thereafter some funds have moved to offer income protection for benefit periods of 5 years or even up to age 60 or 65, often as a substitute for TPD cover. Again, unless such cover includes Superannuation Guarantee contributions, members will be left without an adequate retirement income.

The affordability problems that have affected insurance in superannuation generally have been at their worst with income protection insurance, which accounts for more than 40% of insurance premiums.¹⁸ Accordingly, long term income protection can have a significant impact on account erosion.

Given the above, we submit that any MySuper income protection insurance benefits must include Superannuation Guarantee contributions to be paid to a MySuper-compliant fund and that the benefit period for income protection payments should be limited to 2 years.

5.4 Total/Partial disability

The definitions of total disability vary significantly between income protection policies: ranging from an incapacity to do one of the duties of a claimant's usual occupation, to an incapacity for his/her usual occupation, through to an incapacity for any occupation.

The SIS Act allows for the early release of superannuation benefits on grounds of "temporary incapacity". Regulation 6.01 of the SIS Regulations defines temporary incapacity as being an incapacity for gainful employment because of physical or mental ill-health which is not severe enough to constitute permanent incapacity.

Given the uncertainty and for consistency with the temporary incapacity early release grounds, we submit that a standard definition of total disability should be developed, specifying that a member must be incapacitated for his/her usual occupation because of injury or illness.

To further support a resumption of the accumulation phase, it should also be mandatory to include partial disability benefits in income protection policies.

With regard to the problem of offsetting clauses effectively rendering duplicate income protection insurance policies worthless, it may be problematic to design a statutory mechanism under standard terms and conditions to deal with the prioritisation of particular policies and rebating premiums. We do note that the matter is dealt with under the Insurance in Superannuation Code of Practice, including mechanisms for premium refunds.¹⁹

¹⁸ Ibid.

¹⁹ Insurance in Superannuation Voluntary Code of Practice, clause 11.1.

6. What lead time should be required for the industry to implement standardised terms, definitions and exclusions if this reform was implemented?

Most group life insurance contracts in superannuation have 3-year cycles which may necessitate a 3-year implementation period.

However, the life insurance industry is currently making substantial changes to existing contracts to comply with the Protecting Your Superannuation legislation obligations to cancel insurance on inactive accounts. The legislation was passed in February 2019 and due to come into effect from 1 July 2019.

7. To what extent would standardising terms, definitions and exclusions across MySuper products impact the price of premiums?

AND

8. Would the impact on premiums outweigh the benefits of standardising the definition of TPD, or other definitions, terms and exclusions?

See the above. Further, the cost to all beneficiaries of offering or acquiring insurance of a particular kind or at a particular level and the potential erosion of insurance premiums on retirement incomes are prescribed elements of insurance covenants required of trustees.²⁰

Accordingly, the impact price of premiums and the benefits to members of standardisation to be effectively imposed on trustees in negotiating MySuper group life contracts must be balanced.

The key drivers are affordability and value for money.²¹

9. How could the impact on the price of premiums be mitigated, without incentivising the creation of junk insurance policies?

As detailed in question 3(a) above, some group insurance policies have been criticised for adopting narrow TPD definitions or terms and conditions which operate to exclude or limit potential claims. Some have been labelled 'junk' insurance.

The concern is that if a MySuper TPD definition was mandated, insurance premiums could rise if there was a spike in claims which affected profitability. Conversely, if insurance premiums were fixed, sums insured may reduce if there was downward pressure on profitability.

The alternative to both is the tightening of eligibility terms and conditions.

²⁰ Section 52(7)(b) & (c) of the SIS Act.

²¹ Productivity Commission Report December 2018. Overview, findings at 8.1-8.2.

The competing tensions between benefits, price and eligibility is a perennial balancing act in purchasing insurance. The SIS Act requires trustees to consider all in negotiating MySuper insurance contracts.

That obligation, together with a tightened TPD definition and some standardised terms and conditions will, in our submission, moderate price (premium) pressures and the risk of junk insurance.

10. If terms, definitions and exclusions for MySuper products were standardised, how long would repricing of premiums take to flow through to members?

Presumably insurers would pre-set premiums based on anticipated claims arising from standardised terms and conditions on new contracts. As detailed above, group life contracts in superannuation are usually for three years duration, although many provide for premium adjustments based on rolling claims experiences during the course of the contract.

11. To what extent would standardised terms, conditions and exclusions for MySuper products improve consumer understanding of insurance in superannuation? What particular changes would deliver the greatest benefits to consumer outcomes?

The variation that currently exists in MySuper product terms and conditions and definitions of TPD and total disability has undoubtedly caused confusion and misunderstanding among superannuation fund members.

With limited means or interest in navigating voluminous Product Disclosure Statements, consumers rely on the trustees and their own pre-conceived notions about what they may be covered for.

Standardisation, particularly if accompanied by a plain-English standard form of insurance terms and conditions set out in the IC Regulations, would go some way to improving consumer understanding of insurance in superannuation.

12. Are there other ways to improve consumer understanding of insurance in superannuation without standardising terms/conditions/exclusions?

Key Features Statements (KFS's) have been developed in a handful of financial services products, such as for general insurance home and contents contracts offering flood insurance cover.

They are designed as short form summaries of key terms and conditions of insurance policies and are an acknowledgement that larger PDS's or insurance policy documents do not provide the relevant information in a digestible format.

Such KFS's could be utilised to improve consumer understanding of insurance in superannuation with or without standardising terms, conditions and exclusions.

13. Should maximum, minimum or set levels of cover be prescribed in MySuper products? Why/why not? Should these apply to all types of insurance provided within MySuper products?

AND

14. What factors should be taken into account if minimum, maximum or set levels of cover were to be prescribed?

AND

15. Are there any unintended consequences of mandating a minimum, maximum or set level of cover for MySuper products?

We agree with the finding of the Cooper Review that the minimum level of default death cover imposed after the introduction Choice of Fund legislation 2005 has proved to be largely irrelevant. It was market competition fostered by the introduction of the legislation that drove up sums insured and not the \$50,000 minimum death cover. There was also no minimum TPD cover mandated.

With enhanced oversight from the regulators, APRA and ASIC, coupled with additional public reporting obligations under the SIS Act and further disclosure obligations imposed on trustees by the Insurance in Superannuation Code of Practice²², there will likely be more pressure on trustees to negotiate group life contracts with reasonable levels of cover. However, as is detailed above, this will have to be within the ambit of affordability and excessive account erosion.

Appropriate levels of cover will vary from fund to fund based on membership characteristics. This necessitates some flexibility in negotiating contracts which would likely mean that any mandatory levels of cover would be too modest to be meaningful.

²² The Insurance in Superannuation Voluntary Code of Practice clauses 4.3 and 5.5.