Association of Financial Advisers

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Division Head
Retirement Income Policy Division
Treasury
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By email: superannuation@treasury.gov.au

Dear Treasury,

AFA Submission: Universal Terms for Insurance within MySuper

The Association of Financial Advisers Limited (**AFA**) has served the financial advice industry for over 70 years. Our objective is to achieve *Great Advice for More Australians* and we do this through:

- advocating for appropriate policy settings for financial advice
- enforcing a Code of Ethical Conduct
- investing in consumer-based research
- developing professional development pathways for financial advisers
- connecting key stakeholders within the financial advice community
- educating consumers around the importance of financial advice

The Board of the AFA is elected by the Membership and all Directors are currently practicing financial advisers. This ensures that the policy positions taken by the AFA are framed with practical, workable outcomes in mind, but are also aligned to achieving our vision of having the quality of relationships shared between advisers and their clients understood and valued throughout society. This will play a vital role in helping Australians reach their potential through building, managing and protecting wealth.

Introduction

The AFA strongly supports consumer access to quality life insurance. Trust in the life insurance product is essential to the level of support of the life insurance sector and there are economy wide benefits that flow from this. Confidence in the probability that life insurance will pay out when particular events arise is critical. The vast majority of consumers struggle to understand how life insurance works and what they are covered for, unless they get financial advice. Life insurance products are complex, particularly with respect to the terms under which products which provide disability benefits are paid out. We therefore believe that it is very important for those Australians who choose not to receive personal financial advice, and instead get their life insurance via their employer superannuation fund, that such products should be required to use standardised definitions and be of sufficient quality to reasonably meet consumer expectations in the event of a claim.

Historically, the insurance products made available via financial advisers have been of a higher quality when compared to both insurance sold direct and through employer superannuation funds. Financial advisers have the skills and knowledge to identify which products are better for consumers and based upon the clients personal circumstances, understanding if there might be any complications in the client accessing insurance through particular insurers.

With life insurance, and particularly Total and Permanent Disability (TPD) products, it is understood that there is an important trade-off between price and quality. In many cases which we have reviewed, superannuation fund trustees have been willing to reduce the quality of definitions in order to achieve a cheaper premium. We do not believe that this is in the best interests of superannuation fund members, because it means that they have a greatly diminished chance to make a successful claim. Whilst 'cheap insurance premiums' may help the trustees to sell their fund to consumers, it does not mean that existing and perspective members will understand the level of cover they have, the limitations of the cover or how it compares to other insurance products available within the market. We therefore support both an increase in the quality of the life insurance products made available through employer superannuation and the use of standardised or universal terms.

Another important factor to consider in this debate, is that unlike retail advised life insurance, most group superannuation insurance is not underwritten, provided that the level of cover does not exceed the automatic acceptance limit. An individual member applying for cover above this limit may be subject to individual underwriting. When insurers take on a risk without underwriting, it is understood that there can only be a limited appreciation of the nature and the type of risk that they are accepting. This is one reason why the automatic acceptance limits generally offered by most default superannuation funds are low, resulting in members of these funds generally not having the level of insurance that they would need in an insurable event.

Clients who get financial advice, generally have a significantly better understanding of how much insurance they need and are likely to have a much higher level of insurance than those who rely upon default arrangements. Often these members of employer super funds simply have no understanding of what they or their family might need in the event of their death or disability or the terms and conditions which will affect the outcome of a potential claim.

Currently superannuation fund statements contain inadequate disclosure of key information and warnings with respect to the member's insurance arrangements, including with respect to exclusions. This has led to an insufficient level of knowledge by the general public, and a level of scepticism that claims will actually be paid. In addition, there is a lack of understanding where claims have been denied, perhaps because they did not meet the restricted terms and definitions agree to by the Trustee and set out in the PDS or policy document. This has resulted in negative media coverage and consumer concerns about the value of life insurance. This has broader implications and has been a point of concern for many of the Financial Advisers throughout Australia.

We feel strongly that another important consideration in maximising consumer outcomes with life insurance benefits is for there to be greater controls around the charging of fees by anyone who is assisting a person to obtain a claim benefit. We hear reports about superannuation fund members being charged by legal firms under a no-win no fee arrangement with the amount payable representing up to 40% of the total payout. By contrast many financial advisers do not charge for a standard insurance claim and those who do charge a very low fee by comparison. It should also be pointed out that an adviser who charges a fee for assistance at claim time will generally have a much broader understanding of the client's overall financial position and will be able to make recommendations with respect to the use of any proceeds post claim, in order to help the client make the optimum use of the situation in which they find themselves. To maximise the benefit in the hands of the claimant, there needs to be greater controls on what can be paid to lawyers and other parties who assist with claims.

Response to Questions raised in the Consultation Paper

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

To the extent that some of the TPD insurance products that are available through superannuation are of a lower quality, with particularly challenging conditions to enable payment, the standardisation of terms and conditions is likely to lead to an overall increase in the quality of the product. In making this statement we are assuming that the 'standard' aims to meet the definition of disablement within the SIS Act – which points to a member's existing education, training and experience being the barometer by which a current condition is assessed.

In contrast, we note that some superannuation funds have designed the cover on the basis of a condition that the member is incapable of performing not only the roles for which they would have been suitably qualified based upon existing education, training and experience, but also ***that they could be retrained to do***. This is a very open-ended condition and it means that obtaining a payout will take a longer period and may not be possible at all. It is a matter of fact that these types of prohibitive and restrictive conditions are not included in retail advised life insurance products.

We appreciate that the practical reality is that raising the standard and standardising terms and definitions will lead to an increase in the cost of insurance. This is a natural outcome of products that will pay benefits in more reasonable circumstances. We recognise that increasing the cost of insurance will be challenging for some super funds, however in our view, it is the consumer outcome that should be the primary focus here, which is that they will be paid out when they are injured or experience a serious illness and will be unable to return to work.

In simple terms, the benefit of standardised terms will significantly remove the risk to the consumer when choosing one fund over another and deliver a more consistent approach across the industry.

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?

We believe that the terms and conditions that should be standardised include the following:

- Terminal Illness payout criteria
- The definition of 'any occupation'
- TPD Definitions in terms of Activities of Daily Living
- Exclusions, such as suicide or any period of not being covered
- Pre-existing conditions and implications
- The period for which premiums are guaranteed

3. Should trustees be permitted to offer TPD insurances that differs from the definition of 'permanent incapacity' in the SIS Act? Is the current legislated definition of 'permanent incapacity' an appropriate standard definition of TPD?

The AFA does not agree with super funds offering TPD insurance that differs from the definition of 'permanent incapacity' in the SIS Act. As a minimum, members should not be in a worse position when compared to the SIS definition.

We believe that the SIS Act definition of 'permanent incapacity' is appropriate.

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

The reason for the inclusion of rehabilitation or return to work conditions in TPD insurance is most probably to add additional conditions that might have the effect of reducing the probability of payout. In our view, TPD insurance should be based upon set terms, and in the event of those terms, the benefit should be paid. We would still support measures that encourage rehabilitation, however this should not impact the fact that the insurance contract should pay out when the terms are met.

We support the application of rehabilitation and return to work initiatives in income protection insurance (typically outside super), where the purpose of the insurance is, in most cases, to support a person whilst they are recovering and temporarily unable to work.

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?

We believe that the preferred outcome is to keep exclusions to an absolute minimum and that where they remain, then they should be standardised exclusions. We greatly appreciate that exclusions are used as a risk mitigation measure by the insurers, and this is understandable in the context of the application of auto acceptance limits and the lack of underwriting at the time of application. The need for some exclusions may apply for some occupations.

Standard exclusions that should be addressed, include issues such as self-harm, suicide and living/travelling overseas.

There are three types of insurance made available through superannuation, being life (death cover), TPD and income protection. Each of these three types of insurance serve different purposes and have different types of risk. The exclusions are likely to differ between these types of products, and we are not convinced that there is any necessity to standardise the exclusions across the three product types.

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

In the Group super market, insurance contracts are often put in place for a three year contract period. Thus, the implementation of a regime of universal terms would need to take into account whether the preferred outcome was to wait until the end of the existing policy terms, or through legislative means, force the existing policies to be upgraded.

In our view, it is better to make these changes sooner and not wait for the end of the current insurance terms. Nonetheless, it is appropriate for super funds and insurers to have at least 12 months, from the time of any legislation being passed, to implement the new universal terms.

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

As stated previously, the introduction of standardised terms, definitions and exclusions, would inevitably lead to an increase in the quality of the insurance that is currently available in the group superannuation market. This naturally means that insurers will be taking on greater risk and will need to reprice the premiums accordingly. It is not possible for us to estimate the impact of this, and in any case, it is likely to be different from one fund to another, based upon the existing insurance cover and the risks involved in the groups of people that are covered under a particular superannuation fund.

We believe that an increase in the quality of the insurance cover and an increased probability of insurance payouts would justify an increase in the cost of insurance.

It could be argued that once the standardised approach is in force, the consistency of benefits across insurers will assist in the reduction of complexity, including reinsurer terms which together may lead to a more competitive environment in the long term, with a greater focus upon efficiency and customer satisfaction. This could ultimately drive down premiums given they are the only competitive lever rather than tricky exclusions or “slight” definitional differences.

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

The purpose of life insurance is that many contribute a small amount to a pool so that the relatively few who die prematurely or become incapacitated will receive a payout which they could not have funded on their own. We are very concerned that there are a material number of Australians who have experienced a disability event, yet due to overly prohibitive and restrictive terms in their insurance, they have been denied access to a payout. Many have subsequently and unsuccessfully pursued legal proceedings, only to end up becoming reliant upon social security.

While in the long term, we question whether standardised terms will necessarily universally drive up the cost of premiums, we believe that an increase in the quality of group superannuation insurance and therefore greater protection for those who experience an insurable event, would justify an increase in the premiums that are paid by average Australians through their superannuation fund.

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

We are supporters of an increase in the quality of life insurance by the incorporation of higher quality standardised terms that are more likely to result in TPD payouts. The objective of this exercise is not to lower the quality of products by implementing the standardisation of terms and definitions at a lower level. It is very difficult to mitigate the impact of an increase in the quality of the cover.

We do not believe that this reform should be allowed to lead to the creation of ‘junk insurance policies’.

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

Life insurance is a contract between the policy holder and the insurer, where in return for the payment of a premium, they receive a commitment to pay a claim under certain agreed terms. If those terms are changed then the premium naturally needs to change at that same time. We do not believe that there is any justification for a repricing of premiums to occur at a later time.

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

There is typically a low level of understanding of the insurance that people hold through their superannuation fund. There are many people who do not even know whether they have insurance, let alone the amount or the terms of that insurance. For this to be overcome, there is a need for Australians to have a greater level of engagement with superannuation. Over time, it is expected that this could lead to a greater awareness of the insurance that they have, including the types of insurance cover and the amount.

While standardised terms will reduce complexity, it will take more action for members to have an increased awareness of the terms, definitions and exclusions that apply to their insurance. We see the benefit of standardised terms for consumers being greater certainty about the prospect for payout and therefore greater confidence in their insurance and support for the inclusion of insurance in their superannuation fund.

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

The best outcome for an increased level of consumer understanding of insurance is through access to financial advice, or at least having access to a corporate super adviser and the workplace learning programs that they support.

As discussed above, we do not believe that there are simple solutions to achieve an increased level of consumer understanding and that the benefit is more with respect to improved consumer outcomes with TPD claims and increased confidence in the life insurance product.

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

The experience of most financial advisers, who take on new clients who have existing insurance through employer superannuation funds, is that they do not have enough insurance to cover their family in the event of death, or to cover themselves and their family in the event of disability. Often people don't think about how much cover they need for their existing debt and if they have young children, how much money they would need to cover them for the period before the surviving spouse can go back to work or to cover the cost of child carers or school fees. What young people don't often realise is the amount of money that they would require, even with no debt and dependents, if they were to suffer a TPD event and were not able to ever work again.

We are also conscious that many super funds scale back the level of cover that members have as they get older and approach retirement. What this does not take into account is the level of indebtedness that Australians have, or the extent to which people are having children later in life. These taper arrangements, which do keep the cost of insurance down in the years that it is becoming increasingly expensive, leave many older superannuation fund members with substantially insufficient insurance cover.

Obviously the AFA strongly favours the provision of financial advice to determine the most appropriate level of insurance cover. In the absence of this, we encourage the use of tools to estimate the level of cover. Super funds should not simply taper back the level of insurance cover without any efforts to check with the member as to whether this is consistent with their needs.

In putting minimums in place, there needs to be a straight forward basis to assess this. One option is to use a multiple of the person's income, however more often than not, super funds do not know a person's full income as they may have multiple jobs or may have an employed job and a self-employed business. In the context of having this challenge in working out a person's income, we think it may be appropriate to use a multiple of the average income to set the minimum. This could be around four times the average annual income to ensure that everyone has at least around $350,000 of cover. We think that this should apply to both life cover and TPD. Income protection is already subject to a cap of 75% of income, and we think that most members should be targeting exactly this amount.

Members should continue to have the ability to opt-out of insurance, which will be the case where they have separate insurance that has been arranged through a financial adviser. We believe that higher minimums, with an ability to opt-out, would deliver an overall better outcome.

In terms of a maximum, this is often already set by the automatic acceptance limits that apply to the fund. Above this level, members typically need to be underwritten. It is our view that these controls put sufficient balance in this system and there is no need for the establishment of any additional controls with respect to maximum levels of cover.

Irrespective of what cover is provided, one of the biggest hidden risks to the consumer is the fact that they believe that the insurance provided to them is sufficient or in some way has taken into consideration their personal circumstances. We believe there needs to be clearer messaging that this is not the case.

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

As discussed previously, the best mechanism to work out the required level of cover is through access to financial advice. Where this is not available, then other measures need to be used.

In our response to question 13 we have addressed some of the key considerations. It is worth repeating that the factors to take into consideration are the average levels of debt in Australia, the average number of dependents and the cost of living and supporting a family. Each of these should be considered across different age profiles.

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

As mentioned above, the biggest risk is that members often feel that the amount of cover is based on their circumstances, when in reality it is not.

The expected consequence of setting a minimum is that some members will have a greater level of cover and will therefore be paying more in insurance premiums. As a result, this will have a negative impact upon superannuation balances. This would be an expected consequence, rather than an unintended consequence. Nonetheless, it will ensure that members and their families are better covered when they unexpectedly pass away or are impacted by a TPD event.

Concluding Remarks

The AFA supports further consideration of a system of universal terms for the insurance made available to the members of MySuper funds. We believe this should increase the quality of life insurance and add a level of consistency which will ultimately make insurance simpler to understand and meet the expectations of the majority of members, thus instilling a level of trust that the cover will deliver at a time it is needed the most.

The AFA welcomes further consultation with Treasury should it require clarification of any points raised in this submission. If required, please contact us on (02) 9267 4003.

Yours faithfully,

Philip Kewin
Chief Executive Officer
Association of Financial Advisers Ltd