

10 October 2017

Ms Karen Chester
Deputy Chair
Productivity Commission
Superannuation Inquiry
Productivity Commission
Locked Bag 2, Collins Street East
MELBOURNE VIC 8003

By email: super@pc.gov.au

Dear Deputy Chair,

Insurance in Superannuation Working Group (ISWG) / Draft Insurance in Superannuation Code of Practice

ClearView Wealth Limited (ClearView) made a submission to the Productivity Commission Inquiry (Superannuation: Assessing Competitiveness and Efficiency) dated 23 August 2017.

The purpose of this supplementary letter is to comment on the work of the Insurance in Superannuation Working Group (ISWG) and other related issues.

The ISWG was established in October 2016 comprising representatives from the following bodies:

- The Association of Superannuation Funds of Australia (ASFA);
- The Australian Institute of Superannuation Trustee (AIST);
- The Financial Services Council (FSC);
- Industry Funds Forum (IFF); and
- Industry Super Australia (ISA).

This Group's working priorities were:

- 1.Reducing benefit erosion on superannuation account balances for members, including establishing the right level of automatic cover for young people and low income earners;
- 2.Reducing inappropriate, multiple insurance policies;
- 3.Providing better and more timely assistance to members during claims;
- 4.Improving superannuation fund member communications on insurance;
- 5.Improving data standards to improve service to members; and,
- 6.Undertaking independent research on the costs and benefits of group insurance within superannuation.

We would like to take this opportunity to make a number of observations with respect to the ISWG's discussion paper and draft Insurance in Superannuation Code of Conduct (ISWG Code).

Scope of the Code¹

We note that the ISWG is determined to proceed with two life codes (i.e. the ISWG Code and the recently promulgated FSC Life Insurance Code of Practice or 'FSC Code') and that their amalgamation is a possibility in the future. We consider that this approach is a significant mistake.

Firstly, there is already a community (industry, regulators, government and customers) view that group insurance is exempted from the FSC Code. Nothing could be further from the truth. While the FSC Code does not apply to trustees in group insurance it explicitly applies to the insurer in a group scheme. To embark on the ISWG Code as a separate code merely reinforces this misunderstanding. It will be, as always, the customer who is disadvantaged by ill considered self regulation.

Secondly, a trustee cannot fulfill important ISWG standards without the life insurer's co-operation but the life insurer is not bound by the ISWG Code.²

Thirdly, and this point is also an example of the first point, the ISWG Code does not deal with the relationship between the customer and the insurer on claims; its emphasis in claims is on the role of the trustee. So, the customer must have recourse to the FSC Code for the insurer's standards. But the customer is likely to be told that the ISWG Code applies.

Fourthly, the prospect in the future of amalgamating the two codes is fanciful. Structural change is always difficult. The opportunity should be taken now.

Opt Out Fixed Model

The commercial importance of the *opt out fixed* ('one size fits all') model to the industry is illustrated emphatically by the first sentence of the Foreword to the 'Consultation Paper: Insurance in Superannuation Code of Practice' (Consultation Paper): "automatic issuance on an opt-out basis has been a successful policy for Australia".³ Erosion of retirement benefits by insurance premium is the focus of the ISWG Code.⁴ Thus, the primary purpose of the ISWG Code is to put limits on the erosion of superannuation benefits by insurance premium. If the *opt-out fixed model* were prohibited, the engagement between the superannuation fund member beneficiary would ensure that the superannuation fund member beneficiary was properly advised about the best ratio of erosion for his or her best interests.

Most concerningly, the current draft ISWG Code adopts, without robust debate or consideration, the current *opt out, fixed cover* model.

¹ Consultation Paper, section B1.

² Clauses 3.3, 3.12 and 3.13.

³ Foreword, page 1.

⁴ Foreword, page 1, the Executive Summary and section B2.

While KPMG's 'Review of Default Group Insurance in Superannuation' (September 2017) commissioned by the ISWG has been released as a supporting document to the Code and purports to have considered the merits of changing from opt-out to opt-in insurance, this is unpersuasive given that one of the basic tenets of the ISWG is the preservation of the current opt-out arrangements. Further, the proposals and considerations for all members but particularly for young members continue to assume some "one size fits all" level of fixed cover by age is even appropriate in an Australian workforce in the 21st century that is far more diverse than when opt out arrangements were originally brought into being.

ClearView considers that the current industry practices in *opt out (fixed cover)* arrangements for group insurance in superannuation are a major contributor to poor personal and financial outcomes for many Australians, who as superannuation fund members and beneficiaries, source their life insurance cover through group insurance. ClearView advocates the rejection and prohibition of the *opt out* model and the introduction of an *opt in* model. ClearView advocates that the Code should be reviewed and changed accordingly.

ClearView's reasons are simple. The purpose of the superannuation system in Australia is wealth creation for retirement incomes. The wealth created should be protected by insurance, while acknowledging that the Government's stated objective for the superannuation system does not envisage insurance as an essential element of the superannuation system. The life insurance, whether inside or outside the superannuation system, must be designed and implemented to grant actual and proportionate benefits when a claim is made. The *opt out* model has the effect that the life insurance is not proportionate in either its benefit or its cost but often provides more or less benefit than the beneficiary member needs with the appearance, but not the reality, of cheaper premium.

The superannuation system in Australia is supported by policy settings and comprehensive law. One critical foundation of the superannuation system is that the trustee of a superannuation fund has a broad and deep range of legal (fiduciary and legislative) obligations to act in the best interests of its beneficiaries, the fund members. The trustee's duty to act in the best interests of a member is **not** satisfied by compelling each member to have life insurance cover which is designed to suit a large number of beneficiary members in a segment. In contrast, outside group life insurance, the life insured and the policyowner have access to advice, under regulated processes and standards, to ensure that the person is offered only a **suitable** product.

A superannuation fund beneficiary member does not have practical access to that advice but instead naturally depends on the trustee to act in the beneficiary member's best interests. The trustee is **precluded** from doing so by the *opt out, fixed cover* model. The effect on the life insurer and the trustee is that both financial institutions save expenses by a "one size fits all members or each segment" approach but the beneficiary member is disadvantaged. The outcome is not only a serious breach of the relevant legal standards but also enriches the institutions to the detriment of the beneficiary member. The life insurance industry is using the superannuation system to sell insurance on a gross basis, with minimized expenses and without proper regard to the best interests of the individual's aim to protect wealth.

We criticised in detail in our submission dated 23 August 2017 the "one size fits all" approach, the lack of member education or advice and the unsuitability for an individual of group life insurance cover.

The *opt in* model would prevent these poor outcomes because both the life insurer and the trustee would need to deal with each member to offer appropriately priced insurance with a range of benefits which were suitable for the individual member. Peak industry organisations comprising the ISWG say that they appreciate the need for consumer understanding and awareness while accepting the *opt out* model for the benefit of its life insurance and superannuation industry members.

The reasons that most members of the life insurance sector give to support the *opt out* model discloses their motivations:

1. **Prevention of underinsurance.** The figures of the FSC (one of the constituent organisations of the ISWG) suggest substantial under insurance in the *opt out* model with default cover providing only 20-30% of the cover needed.
2. **Access.** Group insurance certainly gives unhealthy lives wider access to insurance cover but the effect is that they are subsidized substantially by the healthy lives. Even worse, among the healthy lives and unhealthy lives, there are some who pay for cover they cannot claim on (see further comments on this "Access" point, below).
3. **Cost.** The apparent cost advantages are outweighed where the member beneficiary is ineligible to claim, by other inherent cross-subsidises within they current system, and by the under insurance and availability issues above.

The ISWG takes the issue one step further away from the best interests of the customer by alleging that the erosion of superannuation fund beneficiary member balances is not a priority issue. This approach does not bode well for the cultural change and support a successful code must have from the industry, its leaders and its associations.

ClearView therefore advocates that the proper starting place for a consideration of group life insurance and the Code is whether or not the model should be *opt out* or *opt in*.

The *opt in* model would be more efficient in achieving the superannuation system objectives of the Productivity Commission's Inquiry. The issues we raise affect all the Productivity Commission's criteria for assessing efficiency and competitiveness in superannuation in relation to group life insurance: operational, allocative, dynamic and the encouragement of optimal behaviour by customers. The principles of Productivity Commission's criticisms of the current default fund arrangements apply to the *opt out* model for group insurance. The *opt in* model is, like the Productivity Commission's "no-defaults baseline", the objective starting point from which to identify the problems in the *opt out* model. The *opt in* model is also closely analogous to the Productivity Commission's assisted employer choice (with employee protections) model for default funds.

In summary, our view is that *opt in* Group Life Insurance inside superannuation is very difficult to administer to the **benefit** of the members of a superannuation fund. This is best reflected by the fact that the life insurance industry and superannuation trustees have to get together to develop a code to "fix" the obvious inequities in the system. At no

time have they thought about whether life insurance should be provided on an “opt in” basis inside superannuation.

We would respectfully request that the Productivity Commission considers a ‘back to basics’ approach regarding what role superannuation should have in both providing (that is, which products) and funding life insurance premiums.

Further Comments on “Access” Point

Much is often made of the ability to provide a level of cover under the *opt-out* model to members with circumstances (e.g. medical conditions, occupations) that might otherwise make access to such cover difficult in a fully underwritten model. However, it seems to us that while *opt-out* is one way of spreading the cost of providing such access, it is not the only way:

- The cost could equally be spread on a practical basis across all participants of a widely taken-up and valued *opt-in* model with some reasonable anti-abuse controls in place; or
- Other “insurability” charges are possible (on a range of different approaches) to cover this subsidy.

Furthermore, while this “access” point is often referenced by those that support the *opt-out* model, we are not aware of any analysis provided to support the extent to which is it even relevant or significant within the working population, given the restricted benefits provided.

Benefit Design⁵

The Consultation Paper acknowledges that benefit design must be on the basis of: “particular characteristics of their membership in order to determine their insurance needs.”⁶ But the *opt out fixed model* is structurally and diametrically opposed to the espoused approach. And this opposition is evident in the language. By the next paragraph, the Consultation Paper lapses back into a segment approach to insurance benefit design; the lapse, in our view, is driven by the refusal to contemplate a move from the *opt out fixed model*. The segment approach is confirmed by the ISWG Code, clause 4.⁷

The Consultation Paper proposes that the ISWG will develop “good practice guidance” which would assist trustees by detailing “different methods that trustees could use to determine their benefit design and premium limits”.⁸ This illustrates the regulatory and administrative complications of the *opt out fixed model*. The ISWG Code is principles based but then requires a trustee guide to be effective. This adds another layer to the two codes. Would the guide be available to superannuation fund member beneficiaries ? To advisers ?

It is not clear why the cancellation standards for insurance⁹ do not apply to a defined benefit fund.

⁵ Consultation Paper, section B2.

⁶ Consultation Paper, page 7.

⁷ See clauses 4.4-4.6 in particular.

⁸ Consultation Paper, page 8.

⁹ Clauses 4.20-4.24 and footnote 5.

Member informed decisions¹⁰

The Consultation Paper advocates informed decisions by members. But the advocacy is limited to the phase after the member has had a decision made for her or him on entry into the fund. This reaches an odd conclusion in the Consultation Paper in the view that trustees must communicate with members on an ongoing basis: “to prompt members to evaluate whether their cover is appropriate for their current circumstances.”¹¹ Why does this duty not apply from the beginning when the superannuation fund member beneficiary first joins the fund? There is no reasoned explanation for this limited role for a member decision but we observe that the *opt out fixed model* is axiomatic for the group insurance industry and its sales channel, the fund trustees.

The proposal to standardize definitions is laudable but legally poorly informed. It will lead to confusion. A definition in an insurance contract is affected and interpreted by reference to the whole of the contract. So if other terms in the “similar” insurance contracts are different, the definitions will be interpreted and applied differently. The NSW Court of Appeal case *MetLife Insurance Limited v. Maund* stands as a warning against this approach. The trial judge, counsel and the Court of Appeal all differed on some terms of the policy (particularly terms about duration) and the effect was that there were four different opinions on the interpretation of the TPD definition and benefit under the policy. A measured approach to a pilot model wording, which insurers can add to or subtract from, is recommended. We would appreciate the opportunity to develop this approach with the Productivity Commission.¹²

Claims Handling¹³

There are two fundamental and damaging flaws in the Consultation Paper’s approach on this issue. Both arise from the structure of the legal contracts in group insurance. The trustee is the counterparty to the superannuation fund member beneficiaries under the constituent trust deed. The trustee is also the policyowner under the life insurance contract with the life insurer.

The first flaw is that as a matter of clear and old law, the superannuation fund member beneficiary’s primary claim is against the trustee itself. The trustee must balance, with the utmost care, its duties to assess the claim against it and then to pursue the claim so made against the life insurer under the trustee’s policy. It seems as though the trustees are attempting to slough off this fundamental responsibility. The Consultation Paper ignores this critical point but it must be addressed.

The second flaw is that it is impossible for the superannuation fund member beneficiary to read the two codes together to make sense of the standards adopted by the trustee and the insurer on claims. There should be a combined code, at the very least on the claims handling aspect.

Detailed Drafting of ISWG Code

¹⁰ Consultation Paper, section B3 and the ISWG Code, clause 5.

¹¹ Consultation Paper, page 11.

¹² [2014] NSWCA 281.

¹³ Consultation Paper, section B4.

Our submission does not comment in detail on the draft of the ISWG Code. The drafting needs work.

Please let us know if you would like us to elaborate on any of the issues we have raised and if there is any further assistance we can give the Productivity Commission's Inquiry.

Yours sincerely,

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