FINANCIAL SERVICES COUNCIL

3 September 2010

Inquiry into Disability Care and Support
Productivity Commission
GPO Box 1428
Canberra City ACT 2601

By email: disability-support@pc.gov.au

Dear Sir/Madam

Productivity Commission Issues Paper:
Inquiry into a National Disability Long-term Care and Support Scheme

The Financial Services Council (formerly IFSA) is the peak body representing the retail & wholesale funds management, superannuation and life insurance industries. The Financial Services Council (FSC) has over 135 members who are responsible for investing over $1.3 trillion on behalf of more than ten million Australians.

We appreciate the opportunity to comment on the Issues Paper for this inquiry, as well as the extension of time to make our submission.

The FSC is very interested in this inquiry. Our members provide significant financial protection for Australians and their families in the form of life insurance products that provide support in the event of disability, serious illness or disease.

The FSC's view is that if a national disability long-term care and support scheme ('national scheme') is implemented, it should be designed to build on or complement the various existing sources of support.

Such sources of support include government mandated accident compensation schemes as well as insurance cover that Australians have voluntarily taken up to protect against the risk of disability, which may be sustained as a result of an accident, illness or disease.

In making this point, the FSC acknowledges that many Australians with a severe or profound disability (such as those born with such a disability) and their families may currently not have access to any form of support other than social welfare. We clearly accept that this gap in support for these Australians must be addressed as a fundamental inequity in our society.

However, the FSC would also clearly wish the design of a national scheme to be such that it does not create disincentives for working Australians and others who can afford it, to take personal responsibility for insuring against the risk of disability.

Financial Services Council Ltd
ABN 82 080 744 163
Level 24, 44 Market St
Sydney NSW 2000
T. +61 2 9299 3022
F. +61 2 9299 3198
E. info@fsc.org.au
W. fsc.org.au

The FSC also submits that Australian life insurers have resources, and a range of skills and expertise that could be used to support the prudent, efficient and effective operation of a national scheme.

This submission includes a general overview of the life insurance industry in Australia, and descriptions of the range of life insurance products that support individuals and their families in the event of disability, serious illness or disease. Specific matters raised in the inquiry's Issues Paper are also addressed.

1. The life insurance industry in Australia

There are currently 32 life insurance companies registered in Australia.[1] The Financial Services Council represents 28 of the registered life insurance companies.

In APRA's most recent Half Yearly Life Insurance Bulletin, it was reported that, for the financial year ended 31 December 2009, the total assets of life insurers were $230,557 million, and total liabilities were $214,126 million.[2]

The Australian life insurance industry is well capitalised and well run. The resilience of the industry was demonstrated during the financial crisis and can be attributed to the strength of capital adequacy standards, APRA's approach to prudential supervision, and the sound risk, financial and operational management that exists within Australian life insurers.

In a recent Austrade publication, it has been noted that Australia:

> ...has a modern life insurance industry. Products on offer have largely moved away from traditional combined 'investment plus risk' products to more modern, unbundled style products. Although many pension or superannuation products also include risk components, most Australian insurers promote investment and risk-related offerings as separate products. This unbundling took place in the 1970s and 1980s in Australia, whereas in other jurisdictions, it has only taken place in the last decade.[3]

The following is a summary of the 'risk-related offerings' provided by Australian life insurers.

Life Insurance pays a lump sum on death or the diagnosis of a terminal illness. This lump sum can be used to pay off a mortgage and other debts, provide for children's education, obtain childcare and secure the family's lifestyle.

Trauma Insurance (Critical Illness Insurance) pays a lump sum on the diagnosis or occurrence of one of a list of specific illnesses such as heart attack, cancer or stroke. That payment gives the covered individual the choice and flexibility to reduce working hours, spend time with family, and cover the cost of treatment, rehabilitation and care.

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[1] APRA, Register of Life Insurance Companies, www.apra.gov.au

[2] APRA, Statistics, Half Yearly Life Insurance Bulletin, December 2009 (issued 14 July 2010), p 5.

[3] Australian Trade Commission, "Insurance in Australia", September 2009, p 17.

Income Protection Insurance provides a replacement income of up to 75% of the covered individual's current income if he or she is unable to work due to illness or injury. This product is also known as 'Income Replacement Insurance', 'Disability Income Insurance' or 'Salary Continuance Insurance'. It can provide cover for short or long periods and, depending on the policy, payments may continue right up to the age of 65 if the disability is ongoing or permanent.

Total and Permanent Disability Insurance pays a lump sum if the covered individual becomes disabled prior to retirement, and is unable to ever work again, or unable to work in their own occupation. This lump sum can be used to pay off debts, cover medical costs and invest in order to provide an annual income.

Business Expenses Insurance and Key Person Insurance covers the ongoing costs of a business if a person is self employed and cannot work due to illness or injury. Key person insurance covers the losses incurred when a person essential to the success of a business is injured, becomes sick or dies.

2. Designing a national scheme - the need for a detailed 'gap analysis'

The FSC understands that this inquiry is assessing a national scheme that will provide long-term essential care and support for eligible people with a severe or profound disability, where such a disability has not been acquired as part of the natural process of ageing.

We also note that the Productivity Commission has been requested to include an examination of a social insurance model on a no-fault basis, and examine other options that provide incentives to focus investment on early intervention, as an adjunct to, or substitute for, an insurance model.

Given the nature of current risk offerings by life insurers in Australia (which are first party products, and 'no fault'), the FSC submits that a proportion of the Australian population is already covered for some of the financial risk of sustaining a severe or profound disability, whether such a disability is sustained due to an accident, illness or disease.

For example, in a recent report from Rice Warner Actuaries on the Group Insurance market in Australia, it is noted that 'almost all Australian employees receive life insurance through their superannuation fund', and that '32% (Industry and Public Sector) and 23% (Employer Master Trusts) of active members (excluding pensioners) have default income protection cover'.[4]

However, we do accept the following current limitations of life insurance products.

[4] Rice Warner Actuaries, "Group Insurance Market Report: An analysis on life and disability insurance sold under group arrangements", August 2010, pp 4-5.

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T. +61 2 9299 3022 F. +61 2 9299 3198
E. info@fsc.org.au W. fsc.org.au

- They *generally* do not provide protection for those who are born with a severe or profound disability.[5]

- Where life insurance provides a lump sum payment for total and permanent disability, it may not be sufficient (even if invested wisely) to fully provide for the necessary lifetime care needs of someone with a severe or profound disability.

- Where life insurance provides for a partial replacement of income for a period of time, such cover is of value to those with at least an adequate and regular income. For these people and their families, income protection cover is extremely valuable in enabling the continued payment of living expenses (food, mortgage, rent, education costs, utilities, etc). However, it is again accepted that income protection benefits may not be sufficient to fully provide for the lifetime care needs of someone with a severe or profound disability.

- Despite the protective benefits of life insurance for Australians and their families, Australia continues to have a significant underinsurance problem.[6] For example, default cover provided under group insurance arrangements for income protection and total and permanent disability may be only partly sufficient to cover an individual's needs.

While acknowledging the 'unmet needs' analysis that has already been done by the Disability Investment Group[7], the FSC submits that a detailed gap analysis should be done to assess the extent to which Australians (who have a severe or profound disability) are currently having their long-term care needs fully or partially met via an existing accident compensation scheme, or via voluntarily acquired life insurance cover. Such a gap analysis would better enable this inquiry to properly assess the costs and financing of a national scheme, the extent of the demand for such a scheme, and the potential role for the life insurance industry to develop 'gap', or 'top-up' products that could support a national scheme.

The FSC would be happy to provide assistance with information or available data concerning life insurance as necessary for this analysis.

In conducting a gap analysis, we recommend that the inquiry also take account of the recommendations in the MySuper Preliminary Report that was released in April 2010 by the Review into the Governance, Efficiency, Structure and Operation of Australia's Superannuation System ('Cooper Review'). Specific recommendations have been made concerning insurance for the MySuper default fund model, including a recommendation that

[5] Most life companies do offer child cover (death and trauma) from age 2, which parents or grandparents can take out as part of their own policy. However, such cover excludes congenital conditions. Several life companies also offer cover for complications of pregnancy and congenital abnormalities.

[6] The *Lifewise/NATSEM Underinsurance Report* released in March 2010 found that personal underinsurance is expected to cost the government $1.3 billion over 10 years, and that the typical Australian family will lose half (in some cases more) of its income if a parent dies or is unable to work due to serious illness or injury. Lifewise is an industry-wide campaign that aims to encourage Australians to take appropriate steps to protect themselves from the financial hardship that can result from accident, sickness or death. Lifewise commissioned this research to measure the social and economic cost of underinsurance.

[7] Productivity Commission Issues Paper, Disability Care and Support, May 2010, pp 32-33.

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trustees of MySuper products should have the option of offering total and permanent disability and income protection insurance if they believe it is in their members' interests to do so.

If this recommendation were adopted by government, it is likely that an increasing number of working Australians will have at least some level of total and permanent disability and/or income protection cover.

3. Key design elements of a national scheme

There are clearly a number of complex design elements of a national scheme which would underpin the feasibility and effectiveness of the scheme.

FSC members do not, at this stage, have detailed views on how a national scheme should be designed. However, we make the following general comments.

(a) Who should be eligible?

FSC members do not have a view about the disability criteria for eligibility, except to say that such criteria would need to be very clear, and strictly maintained over time. Such discipline would be critical in order to maintain stability of the funding model.

Further, if access to a national scheme were based on people's income or assets, the life insurance industry could develop 'gap' products that would cover those who, following an injury or illness, would meet the disability criteria, but who would not be eligible under any income or assets test. Such products could be in the form of annuities that could effectively mirror the long-term care support or services that would have been received under the national scheme.

Such 'gap' products for long-term care support and services could complement life insurance cover already available in the form of income protection insurance (which typically covers daily living expenses) and total and permanent disability insurance (which provides a lump sum amount, and which can be used in a flexible manner by the recipient).

(b) Financing options and the role of insurers

The Issues Paper identifies the two forms of financing as 'pay as you go', and a funding method that manages future liabilities.

Whether a national scheme is publicly funded (via a tax or levy) or privately funded (via premiums paid by individuals), a method that manages future liabilities is a more stable and equitable funding model. Critically, such a model provides inter-generational equity and fairly distributes the costs of the scheme.

Further, the FSC submits that a 'pay as you go' model, would (due to prudential requirements for insurers to manage future liabilities) need to be publicly funded. As such, a 'pay as you go' national scheme would be subject to greater short-term fiscal and political pressures. It would also require the Commonwealth Government to take on board

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significant future fiscal liabilities which could potentially adversely impact the Government's credit rating.

The life insurance industry has a great deal of experience in pricing, reserving, and investing to meet the requirements of a model that manages future liabilities.

Indeed, under an 'insurance model' for a national scheme, the insurance industry could play a range of roles in a national scheme including:

- capital solutions to fully or partly fund a national scheme;
- capital and asset management;
- collation of population and disability data and trends analyses;
- the pricing of risk, premium setting and underwriting;
- risk management;
- injury management;
- claims management; and
- product design (eg, annuities) that could fund care needs over a lifetime.

This occurs now in some States in relation to injury compensation, including for those who become severely disabled from injuries that occur as a result of workplace accidents, motor accidents and medical procedures.

A similar insurance model that draws on the capabilities of both life and general insurers could be designed for a national scheme.

4. Conclusion

This submission has only dealt with a small number of the issues arising out of this complex and important inquiry.

We would be happy to provide further available information or data in relation to life insurance in Australia as the inquiry may deem necessary, and we look forward to continuing our involvement.

Yours sincerely

MARTIN CODINA
Director of Policy