6th March 2012

Parliamentary Joint Committee on Corporations and Financial Services
PO Box 6100
Parliament House
Canberra, ACT 2600

Submission on Insurance Aspects of the
Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012

Professional Financial Solutions (PFS) is pleased to provide this submission in relation to the Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012 and Explanatory Memorandum. In this submission we raise critical issues which we recommend be addressed by amendments to in the Bill and the Explanatory Memorandum.

About PFS

Professional Financial Solutions (PFS) is an independent consultancy established in 2001. We provide insurance, superannuation, actuarial, risk management and related consulting services to a wide range of clients. These include superannuation funds, life and general insurers, professional associations, statutory bodies, and corporations in relation to their employees' superannuation and benefits.

This submission has been prepared by Rhonda Virtue, Principal, Group Insurance. Rhonda has over 20 years of experience and is well known in the industry as one of Australia's leading consultants in group insurance. Her experience encompasses strategic advice to trustees, product design and policy drafting, management of large group insurance tenders, overseeing of change implementation and insurance administration advice.

1. Proposed Section 29VN Additional obligations of a trustee in relation to a MySuper product

Whilst insurance requirements are due to be expanded in later tranches of legislation under the Stronger Super reforms, the list of trustee obligations in proposed section 29VN does not include any reference to the provision of death and disability insurance benefits.

These benefits should be given at least equal importance to the net returns currently noted in proposed Section 29VN (a).

2. Insurance Covenants: Proposed Section 52(7)(a) and Explanatory Memorandum paragraphs 1.92 to 1.94.

Given the significant, though not widely recognised, operational risks relating to insurance administration and member communication in respect of insurance, we recommend the insurance strategy requirements in proposed Section 52(7)(a), and Explanatory Memorandum paragraphs 1.92 to 1.94, be expanded to include the following matters:

- *the terms and conditions of the superannuation fund's insurance policy/ies are accurately reflected on administration systems; and*

- *the terms and conditions of the superannuation fund's insurance policy/ies are correctly communicated to its members.*

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Reason for inclusion of the above

Our concern is the absence of any specific reference to consideration of what is, from our substantial market experience, the most significant operational risk of insurance. Ensuring the terms and conditions of a superannuation fund's insurance policy/ies are accurately reflected on systems and correctly communicated to its members should be a paramount requirement. If this is not the case it represents significant operational risk and is definitely not in the beneficiaries' best interests.

It is relatively easy for a trustee of a superannuation fund to demonstrate that the insurance provided is in the best interests of beneficiaries, having regard to the characteristics of its membership. Professionally run insurance reviews would already commonly include the requirements for the insurance strategy in section 52 (7) (a) in the Bill.

What is less evident, in our experience, is the regard given to the following:

- Consideration of any issues in respect of the administration of the existing insurance policy prior to embarking on a new or revised set of arrangements.

- Regular review of the insurance to ensure consistency between policy documents, systems and communication to members.

This represents a significant weakness in the system which should be addressed.

Insurance errors are frequently systemic affecting large percentages of superannuation funds' memberships. In very broad terms, these result in either members being advised they have cover, which is not provided to them under the terms of the policy, or to a somewhat lesser degree, members not being provided cover to which they are entitled. Particularly given the high levels of automatic cover and generous reinstatement of cover terms now being provided across the market, these operational risks are substantial. For the most part, however, our experience of reviewing the insurance arrangements of a wide range of superannuation funds strongly suggests these operational risks are not receiving adequate attention.

In the past, occasional administration and communication oversights by trustees and their administrators have frequently been borne by insurers and reinsurers. The very high levels of default cover now regularly being seen in the market means it is much more likely insurers and reinsurers will be looking to trustees to meet the cost of their insurance errors.

If the requirement for consideration of these operational risks is not included in the insurance covenants, there is a very real danger they will not be given the consideration by trustees they deserve, and fund beneficiaries will ultimately be adversely impacted. Clearly the reverse is the intention of this legislation.

3. Insurance Covenants: Proposed Section 52(7) and Explanatory Memorandum paragraphs 1.95 to 1.97.

We strongly believe the proposed insurance covenant in respect of the inappropriate erosion of the retirement income of beneficiaries is unattainable, and therefore recommend the following:

- Amend section 52 (7) (c) as follows (amendment noted in bold):

  To only offer or acquire insurance of a particular kind, or at a particular level, if the cost and terms and conditions of the insurance ***~~does not inappropriately erode the retirement income of beneficiaries~~ are considered reasonable having regard to the demographic composition of the beneficiaries of the entity.***

- Add a new section 52 (7) (d) as follows:

  To only provide reinstatement of cover terms and conditions which do not inappropriately erode the retirement income of the beneficiaries; and

  renumber the current section 52 (7) (d) as 52 (7) (e).

- Amend paragraph 1.95 of the Explanatory Memorandum as follows (amendment noted in bold):

  Each trustee of an RSE will be required to consider the cost to all members when offering insurance of a particular kind or level and should only offer insurance of a particular kind or level if ***due regard has been given to the demographic composition of the beneficiaries of the entity, and the reinstatement of cover terms provided*** *do not inappropriately erode the retirement income of the beneficiaries. This recognises the importance of trustees balancing the needs of members with respect to insurance cover offered and retirement incomes.*

Reason for changes above

Amendment of section 52 (7) (c) – inappropriate erosion of benefits

The requirement of proposed section (c) of the Insurance Covenants place superannuation fund trustees in a virtually impossible position.

Trustees generally devote a considerable amount of time, cost and energy to understanding the membership profile of their fund. They generally have a good understanding of their members' age and gender and often a broad idea of the industries in which they work. They also have some sense of members' salaries, based on employer contributions, and know their members' account balances within their particular fund. However, trustees only have a superficial knowledge of the financial situation of any of their funds' members. Regardless of any common demographics, trustees can have no certainty of financial commonality of their fund's beneficiaries.

For some members, insurance cover will be their priority, for others it will not. Trustees can only do their best in formulating default insurance options, based on a broad understanding of their memberships. Ultimately, the value of cover available has to be for each individual to decide.

Inclusion of a new section 52 (7) (d) – reinstatement of cover

In our extensive experience there is a growing problem relating to the reinstatement of cover terms commonly seen in insurance policies of superannuation funds. There needs to be a requirement for reinstatement of cover terms to be considered in respect of the financial interest of members. It could well not be in the financial interest of a member receiving spasmodic employer contributions to continually have their replenished account balance completely eroded by the reintroduction of insurance and the respective premiums.

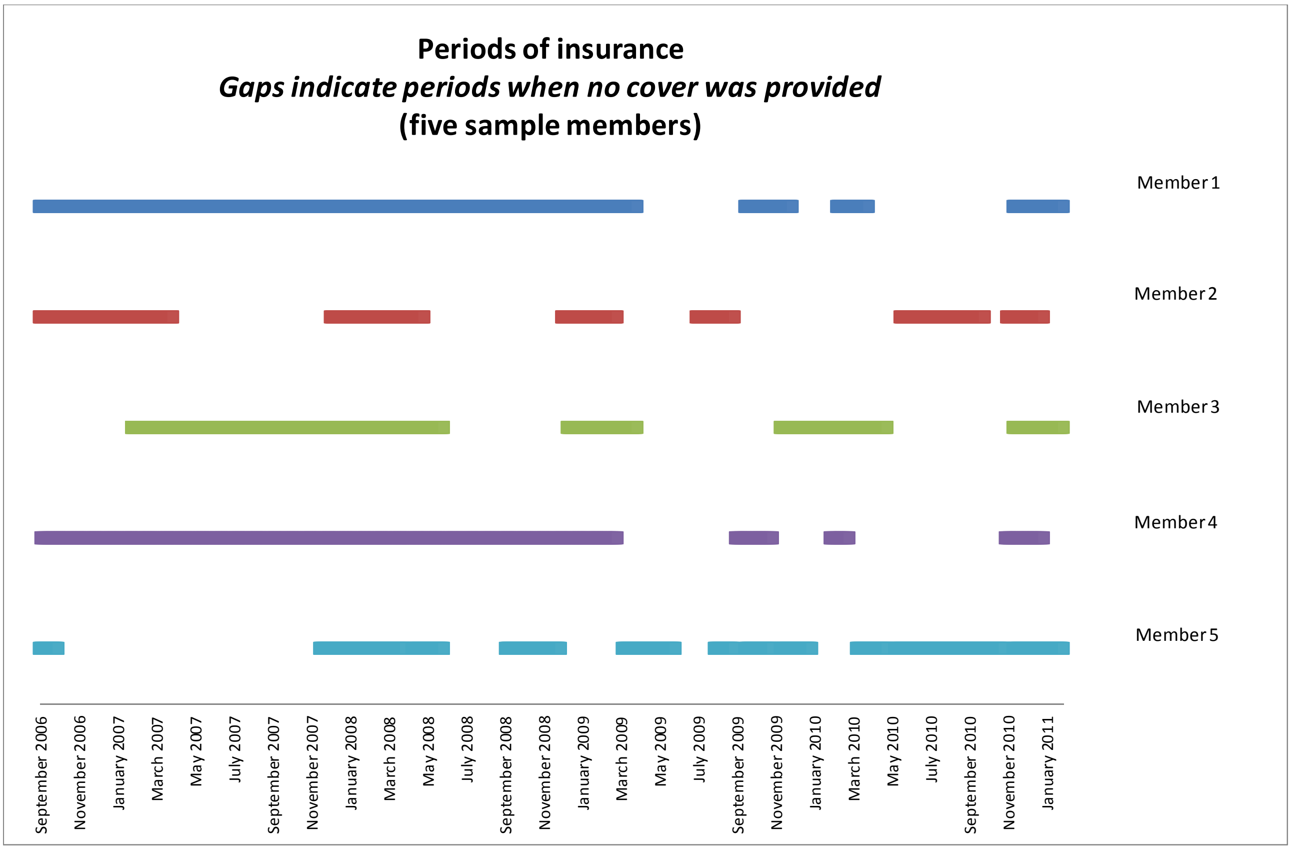
This is illustrated in the graph below for a sample group of actual members of a significant superannuation fund which we have recently reviewed. The graph clearly demonstrates the intermittent periods of cover provided to these members each time sufficient contributions were received into their account to cover the premiums required to re-establish their cover.

Part of a trustee's insurance strategy should be to give this matter, and its management, due consideration.

We believe reinstatement of cover conditions are so important that they should be specified in the Insurance Covenants, and not just in the Explanatory Memorandum, to avoid being overlooked.

Enabling the reinstatement of a member's cover, which had been previously cancelled due to an insufficient account balance, has merit where the maintenance of insurance is important to the member. However, there are many thousands of superannuation fund members, receiving irregular SG contributions from their employers due to the intermittent nature of their work, who are oblivious to being adversely impacted by these terms, when it is in fact building of their retirement savings that is their priority.

Retirement incomes of such members are being eroded, and often completely, because of highly flexible and sophisticated reinstatement of cover terms even though only intermittent cover is being provided.
It is important to note that this is a separate issue from the actual cost of insurance, which may well be appropriate for the membership as a whole. It is an issue for affected members who commonly would not know when they do and when they do not have cover.



General comment on Stronger Super insurance provisions

The Government has advised that later tranches of the Stronger Super legislation will include further detail on insurance requirements. However, the delay in issuing those requirements has substantial implications for the superannuation industry, and many fund members. These include the unnecessary erosion of members' retirement costs due to additional costs of implementing those requirements within restricted timeframes, with an attached increase in operational risk.

Consideration may need to be given to deferring the date for the commencement of MySuper to ensure insurance matters are properly catered for in the new regime.

We therefore strongly recommend, in respect of already flagged insurance changes, the following:

(1) As a matter of urgency, Treasury investigate the possible adverse implications for beneficiaries in respect of the following:

 a) Changes to funds' current definitions of disablement to align with the Superannuation Industry (Supervision) Act 1993 conditions of release; and

 b) Current employer insurance arrangements, with less than the 500 members stipulated for tailored MySuper products, noting there are many thousands of these.

(2) After undertaking the above, promptly release of all details on insurance requirements for MySuper products , in the form of an exposure draft bill and explanatory memorandum.

As the writer of this submission, I have over twenty years of first-hand experience dealing with operational risk issues emanating from unsound administration of group insurance policies and deficiencies in insurance communication to superannuation fund members.

PFS would very much welcome the opportunity for me to appear at the Parliamentary Joint Committee Public Hearing in respect of this legislation. I can provide practical insight to insurance at a level not generally held by those representing the broader views of the industry.

Further information on PFS and myself can be found on our website, www.pfsnet.com.au

Please contact me on (02) 9225 6116 if you would like to discuss this matter.

Yours sincerely

Rhonda Virtue

Rhonda Virtue
Principal