

8 October 2012

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

By email to: corporations.joint@aph.gov.au

Dear Dr. Grant,

Inquiry into the Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Bill 2012—Submission on insurance-related aspects of the Bill

Professional Financial Solutions (PFS) is pleased to provide this submission on the Superannuation Legislation Amendment (Further MySuper and Transparency Measures) Bill 2012 (the “Further MySuper Bill”) and its associated Explanatory Memorandum.

Our comments in this submission are restricted to aspects of the Bill relating to insurance, an important but frequently overlooked part of the superannuation system. The MySuper reforms are, in part, intended to address this with measures such as the new requirement for MySuper products to include insured death and permanent incapacity benefits.

We have a number of concerns with the Bill, which we discuss in more detail below.

1. Timing of the new provisions

The Stronger Super legislation is being considered by Parliament in a number of “tranches” of which this is the third. At least one more tranche of legislation is planned (Explanatory Memorandum page 5). Various items of exposure draft legislation have also been released by Treasury for consultation, potentially with more to come, as well as considerable detail to be provided in regulations and APRA guidance material which have not yet been released even in exposure draft format.

There is considerable work still to be done by superannuation funds across the board in relation to the Stronger Super reforms, involving structural changes, changes to systems and processes and communications with members. Even with the three-month extension to the commencement date resulting from the earlier tranches of legislation, there is very little time available for funds to prepare for the reforms properly, considering that much of the detail is not yet available.

In relation to insurance, the reforms will require negotiation with insurers on changes to life insurance policies held by funds, and potentially appointment of new insurers, as well as changes to member disclosure and changes to administration systems.

Many multi-employer funds provide specific employer insurance arrangements. Thousands of these relate to employers with fewer than 500 members in a fund. The cover offered under these arrangements is often better than what is likely to be provided to those employees under a MySuper arrangement.

The very tight deadlines available to implement the Stronger Super reforms means that trustees of multi-employer funds may not have the time or resources to properly manage this issue and ensure the best interests of these members are met.

The same strain on limited resources also means that employers of corporate sub-plans will generally not be able to transfer their plan to another provider if the current trustee is not willing or able to maintain their insurance arrangements. (The feasibility of this is also affected by the proposed legislation providing CGT rollover relief not extending to the transfer of such plans.) Members of such plans may lose valuable cover if transferred to a generic MySuper product. Members who wish to replace lost cover, may find themselves unable to obtain that cover again because of worsening health. Replacement cover may well be more expensive than the lost cover.

Recommendation 1: Defer the commencement date for MySuper and related Stronger Super reforms to give trustees and members sufficient time to consider all of the implications of the final legislation and regulations properly, and advise them to members.

2. Provision of different insurance benefits to different groups of members

Explanatory Memorandum paragraph 2.20

The Explanatory Memorandum states *“Trustees may offer each member of the fund the same minimum level of default life and TPD insurance or they may vary the minimum level either across different workplaces or at the member level... In practice, this gives trustees the option of providing different levels of default insurance cover to different categories of employees within a particular workplace, reflecting their different insurance needs.”*

This flexibility, which we strongly support, does not appear to be stated explicitly in the Bill. As such, providing tailored insurance in line with the Explanatory Memorandum would be a breach of section 29TC(1)(b) of the Superannuation Industry (Supervision) Act, as amended by the earlier tranches of the Stronger Super reforms.

In addition, this paragraph is limited to death and permanent incapacity benefits. Similar issues apply to income protection (salary continuance) insurance which funds may provide either as default or voluntary insurance. The latter insurance should also be permitted to vary for different categories of members.

Finally, while the Explanatory Memorandum refers to different *levels* of cover for different groups of employees, it is not clear that different *types* of cover are permitted for different groups (e.g. only providing income protection insurance for a particular group of employees of an employer).

Recommendation 2: Amend section 29TC of the SIS Act to clarify that funds are not required to provide the same type or level of insured benefit to all MySuper members.

3. Minimum insurance requirements: confusing terminology

Proposed Superannuation Industry (Supervision) Act (SIS Act) section 68AA

The terminology and structure of proposed SIS Act section 68AA *Benefits for permanent incapacity and death* is confusing, in particular its use of the terms “death benefit” and “permanent incapacity benefit” and funds “providing” these benefits.

Normally, a fund *provides a benefit* to a member when it pays an amount to that member in cash or as a rollover. The Bill, however, refers to a fund “providing” death benefits and permanent incapacity benefits in relation to a member’s contingent entitlement to an insured benefit which is payable, respectively, on death or disablement.

In other words, using the Bill’s terminology, the fund “provides a benefit” when a member receives insurance coverage supporting insured death and permanent incapacity benefits paid by the fund, regardless of whether a benefit is actually payable to the member at that time.

It is therefore unclear whether the “reasonable conditions” referred to in 68AA(3) and (4) relate only to the provision of insurance cover (as indicated by the Explanatory Memorandum) or could also relate to eligibility for a member to be paid an insured benefit on the event of death or permanent incapacity.

Similar terminology is also used in the Explanatory Memorandum, such as paragraph 2.13 which states “...a fund that accepts contributions for employees must actually provide benefits to each member of the fund in respect of death at the minimum level set out in the SG Regulations...” The Explanatory Memorandum, however, also uses alternative (and inconsistent) terminology in other sections, such as paragraph 2.11 which refers to “the kinds of benefits that may be offered by way of insurance”.

Recommendation 3: Reword propose section 68AA to remove confusing terminology and clarify its meaning.

4. Minimum insurance requirements: opting-out and then opting-in again

Proposed SIS Act section 68AA, Application provisions for that section

Proposed section 68AA requires that the fund provides a death benefit and a permanent incapacity benefit “to each MySuper member of the fund”.

This could result in selection against the fund. For example, a “choice” member who had previously opted out of insurance or had had insurance cover lapse, could transfer to the fund’s MySuper product to gain automatic insurance which would not otherwise be available without underwriting.

Item 7 in Part 2, Schedule 2 to the Bill provides that a MySuper who had opted out of insurance prior to the commencement of that item will not receive automatic cover under section 68AA. We suggest that those provisions be extended. For example, a member of a fund who has opted out of insurance at any time will not have to be offered insurance by that fund under section 68AA.

5. Expanded definition of permanent incapacity

Proposed SIS Act section 68AA(1) and paragraphs 2.16 and 2.5 of the Explanatory Memorandum

We recommend expanding the proposed SIS Act section 68AA to allow the payment of this benefit if the member is suffering permanent incapacity or other forms of disablement consistent with those defined in Income Tax Assessment Regulation 295.465.01, which are fully deductible if included in a policy with an “any occupation” definition of TPD. These include loss of limbs, cognitive loss, and the inability to perform activities of daily living or domestic duties which are commonly found in superannuation fund insurance policies.

Recommendation 4: Amend the definition of permanent incapacity, either in the SIS Regulations or in proposed section 68AA to include cover for events such as loss of limbs, cognitive loss, and the inability to perform activities of daily living or domestic duties which are commonly found in superannuation fund insurance policies and are fully deductible under Income Tax Assessment Regulation 295.465.01.

6. The ability to opt-out of insurance

Proposed SIS Act section 68AA(6) and paragraphs 2.8 and 2.19 of the Explanatory Memorandum

Section 68AA(5) and (6) provide that a fund can:

- let a member opt out of his or her choice of one or both of the death benefit and the permanent incapacity benefit or
- require a member who wishes to make such an election opt out of both the death benefit and the permanent incapacity benefit.

This does not allow for the common situation where a member can choose “death only” insurance (i.e. opt out of TPD insurance but retain death insurance). Presumably this is a drafting error.

Recommendation 5: Amend section 68AA(6) to allow funds let members opt out of TPD insurance but retain death insurance.

7. Reasonable conditions under which a fund will not have to provide death and TPD insurance.

Proposed SIS Act section 68AA (3) and (4) and paragraphs 2.17 and 2.18 of the Explanatory Memorandum

Clarification is required in regard to the reasonable conditions under which a fund will not have to provide death and TPD insurance. As it currently stands, the Bill and associated Explanatory Memorandum contain considerable loopholes that could be used to undermine the intention of the legislation.

The examples of reasonable conditions provided in paragraph 2.17 of the Explanatory Memorandum effectively open the way for trustees to avoid the need to provide death and TPD insurance to the majority of their members, which is against the intent of the legislation.

For example, placing a restriction on the number of hours worked per week could exclude all casual workers from insurance.

The statement in paragraph 2.17 of the Explanatory Memorandum “*Where a trustee has taken out insurance, a condition is also considered to be reasonable if it is the same or corresponds with the terms and conditions of the underlying insurance policy*” overrides the general requirement that each fund must provide members with both death and TPD insurance.

Recommendation 6: Provide some limitations on the insurance policy terms and conditions which can override the requirement to provide death and TPD insurance for members, to ensure the intent of the legislation is met.

8. The need for trustees to consider the impact of the cost of insurance at an entire membership level

Paragraph 2.22 of the draft Explanatory Memorandum

There are inconsistencies between paragraph 1.96 of the explanatory memorandum (EM) to the Superannuation Legislation Amendment (Trustee Obligations and Prudential Standards) Bill 2012 (the “Trustee Obligations Bill”) and paragraph 2.22 of the Further MySuper Bill in relation to consideration of insurance at an individual rather than a group level.

Paragraph 1.96 of the Trustee Obligations Bill states that the requirement to consider the impact of cost of the insurance offered on the retirement income of beneficiaries “does not apply to the circumstances of individual members”. In contrast, paragraph 2.22 of the Further MySuper Bill states that trustees may determine minimum levels of insurance depending on what is in members’ best interests, without specifying that this does not apply to the circumstances of individuals.

Paragraph 2.22 of the Further MySuper Bill allows trustees to vary the minimum level of insurance “across different workplaces or at the member level” and includes an example that this gives trustees the option of providing different default insurance cover “to different categories of employees within a particular workplace.” It is not clear if the statement “at the member level” is intended to allow for grandfathering of current insurance cover, or for another purpose.

Recommendation 7: Clarify that trustees are not required to consider insurance requirements at the level of individual members.

9. Phasing out of non-permitted insurance

Proposed SIS Act section 31(2)(ea) and (eb); Paragraph 2.27 of the draft Explanatory Memorandum

Loss of benefits

We have one concern in relation to the prohibition of funds offering insurance definitions which are not directly aligned with the definitions used in the conditions of release in the SIS Regulations (e.g. “own occupation” definition of total and permanent disablement¹).

(1) Members who wish to replace the ‘own occupation’ cover they are losing, outside of superannuation, may find themselves unable to obtain that cover again because of worsening health.

Timing of phasing out

This paragraph indicates phasing out of non-permitted insurance policies is to be prescribed by Operating Standards to be included in the SIS Regulations (which have not yet been released for consultation).

In practice, funds may be required to phase out non-permitted insurance at an earlier date as APRA’s draft *Prudential Standard SPS250 - Insurance in Superannuation* states this will occur under a time-frame to be agreed with APRA in writing.

We note that it is the non-permitted definitions of permanent incapacity in insurance policies which needs to be phased out, rather than non-permitted insurance policies. The rest of the relevant insurance policy is unlikely to be significantly impacted by the required change to its TPD definition.

There will be few, if any, insurance policies which contain definitions exactly matching the current conditions of release in the SIS Regulations, hence it will not just be policies with own occupation definitions which will be affected.

Given the available time frames for the readiness of MySuper products, it is anticipated most funds will look to obtaining endorsements to their existing policies to accommodate the new requirements. This would seem to be a far more manageable proposition for the industry as a whole.

Recommendation 8: Allow grandfathering of own occupation definitions currently held by members.

10. Accrued default amounts and insurance proceeds

Proposed SIS Act section 20B

Superannuation funds commonly invest the proceeds of a death benefit insurance claim in a cash investment option while the trustee determines which of a deceased member’s beneficiaries will be paid the benefit. This determination can take months or even longer as information must be sought from potential beneficiaries. Investing the proceeds of an insurance claim in cash will avoid the insured amount being

¹ In practice, most funds use the term “Total and Permanent Disablement” (TPD) benefits rather than “permanent incapacity” benefits.

subject to the volatility of investment markets, and potentially being reduced by negative investment returns.

Under the Bill, the proceeds of a death benefit insurance claim could potentially be classed as an accrued default amount, and hence transferred to a MySuper account. This may not be appropriate.

Recommendation 9: Amend the Bill to ensure that the proceeds of a death benefit insurance claim are specifically excluded from the definition of accrued default amounts.

Further information on PFS can be found on our website, www.pfsnet.com.au. Please contact me on (02) 9225 6100 if you would like to discuss any of the issues raised in this submission.

Yours sincerely

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