RICEWARNER
Insight like no other

7 April 2017

The Insurance in Superannuation Working Group
Project Managers Office

By email: ISWG-PMO@kpmg.com.au

Discussion Paper: Account Balance Erosion Due To Insurance Premiums

Thank you for the opportunity to comment on your initial discussion paper. We have limited our comments to your more overarching questions, those in Sections B1 and B2, and the initial question in B3. We look forward to seeing your later drafts of this paper and the other papers that are to follow.

We consider your questions in turn below.

B.1. Questions

Establish design principles to be adhered to when determining automatic cover and affordable premium levels.

1. Do you support the development of guidance on the determination of appropriate cover levels? If not, why not?

Guidance would be useful so long as it is flexible enough to cover most members of most funds. This is obviously a challenge when a single fund may offer cover to a wide range of employees such as:

- Professionals and special risk employees.
- Full time permanent employees and short term casual/seasonal employees.
- Those without any need for cover and those with no cover but a significant need.

2. What should be the trade-off between prescription and flexibility in this guidance?

Prescription simplifies compliance and allows clearer and consistent consumer messages, which is desirable for default members. However, unless the prescription is very carefully crafted and detailed it may impose restrictions on funds' benefit design initiatives that many may feel are inappropriate.

If prescription was favoured, consideration should be given to defining a class of member to whom the prescription would apply, in a similar manner to the MySuper requirements i.e. only applying to default members.

Guidance can deliver the same messages but will include more flexibility. This will allow funds to justify (to their Trustee and APRA) why their benefits are appropriate for their members even if they are a little outside the guidance limits in some areas.

Should the guidance be tailored to certain cohorts (particularly age)? What flexibility is needed to cater for different demographics e.g. members who have casual employment patterns?

It is important to get the right balance between too much tailoring which will make it harder to set clear rules and more difficult to explain to consumers, and having enough tailoring to be appropriate for different demographics.

Logically the guidance would be tailored to certain cohorts of members influenced by factors such as:

- The expected level of superannuation contributions (age, employment status, occupational grouping).
- The premium rates (age, occupational grouping, possibly gender for IP).
- The expected level of account balances, possibly past and current fund (age, employment status, occupational grouping, possibly gender).
- Possibly the proportion of expected insurance needs that the fund wishes to meet through its insurance provisions.

3. What would be the consequences of just applying to new members as opposed to existing members?

If guidance rather than prescription is given, it should be applied to all members rather than just new members, given the relatively small proportion that new members represent of the total membership of most funds and the fact that a member's circumstances can vary considerably throughout their membership. This does present some challenges in developing transition rules for current members but seems preferable to having much publicised new provisions that only apply to a small proportion of the membership.

4. What would be the impact in terms of cost for funds/insurers in using principle-based guidance?

Any changes that necessitate the restructuring of insured benefits will impose significant costs on funds. The costs will arise from factors such as:

- The analysis required to determine the form of the new benefits, including transition provisions for current members.
- Negotiations with the insurer to agree on any required rate changes.
- Communications, updating documentation, system and process changes.

The costs to insurers will also be significant but somewhat less than those of the funds. Repricing benefits and updating documentation and systems will be the major sources of costs.

These costs could be limited to some degree if (as mentioned in 2 above), a class of member subject to any new provisions, was defined with other members being unaffected.

5. If there was a focus on individual cohorts – are young and the older Australians the appropriate grouping?

See response to second part of Question 2.

6. Are the age bandings correct? Alternatively, should Young = < 21 and Older = > 60?

The currently suggested age thresholds of 25 and 55 better fit the study and work profile of the population than 21 and 60. Many post school education/training courses extend past age 21. Although many are continuing employment well past 55, many are reviewing their work regimes during their fifties. The shape of the TPD and IP rate curves make 55 a suitable threshold.

It is likely to be easier to fix more widely applicable limits if the bottom end was taken out by establishing different provisions for low income earners. With AWOTE at about $80,000 pa, those earning less than 30% of AWOTE (about $2,000 per month or $400 per week if these limits are easier to work with) could be restricted to the SG minimum levels of cover unless they opt for standard default cover or higher levels.

Getting the right balance of recognizing needs and higher expected claims rates without unduly complicating the system remains a challenge. You could contemplate having separate threshold tables for *low risk* and *standard* occupations.

7. Are there any other considerations that should be called out?

There have been recent calls to (significantly) reduce the levels of default cover, in the expectation that those needing (and able to afford) more cover will take out the required additional cover.

Given the modest levels of usage of additional voluntary and the observed levels of anti-selection related to that cover, such a move would be likely to:

- (Significantly) reduce the overall level of cover.
- Increase the proportion of anti-selection.

B.2 Questions

Define 'inappropriately erode'.

8. Do you have a view as to what the definition should be or should reference?

The table in Section B2 of the draft paper is a good start (referencing age, employer contributions, account balance and percentage of members impacted).

It would be worthwhile expanding these parameters to include a measure of work status/expected income during the year. This may raise claims of discrimination or difficulty of administration. With average full-time adult earnings, currently at about $80,000 pa, it would be reasonable to restrict default insurance for those expected to earn less than $20,000 pa. This would include those who are temporarily out of the workforce e.g. maternity leave. The SG minimum level of cover is death cover provided by a premium of fifty cents per week. With TPD now being commonly provided and the fifty-cent limit being set many years ago, higher levels would now be appropriate such as:

- $2 per week for those under 25.
- $4 per week for those over 55 to take account of their expected total superannuation balances.
- $3 per week for other member earning less than 25% of average weekly full time adult earnings.

In many cases salary information will not be available, particularly if members are working casually and would need to be estimated from superannuation contributions.

The group above would only be subject to the $ per week test.

For other members, suitable maximums would be:

- 1 – 3% of salary increasing with age.
- 8 – 10% of projected total account balances at retirement (considering all accounts).

The overall requirement would be that 90% of members should satisfy either the salary or account balance test.

The Rice Warner *Affordability Study* carried out in 2016, indicated that many funds are currently providing default insurance within these limits for most members.

9. What definition or interpretation are you currently employing in your fund(s)?

The definitions currently used are tailored to individual fund demographics and salary/account balance levels.

Broad reference points are 1% of salary (or corresponding proportion of SG) and 8% of projected account balances.

10. Are there specific cohorts of members that need to be considered in a definition? Why?

As noted in the response to Question 2, it is desirable that the class of members to whom the maximums should be applied should be defined. Members, who select additional cover, receive employer support in the form of additional contributions or are subject to employer selected benefit designs could be excluded from the standard tests.

Likewise, those earning less than $20,000 pa should only be subject to the dollars per week tests.

Other members should be subject to the standard tests.

Establish overarching prescribed maximum premium levels for automatic insurance coverage.

11. Should maximum thresholds be prescribed?

As mentioned in Question 2, prescription simplifies compliance and allows clearer and consistent consumer messages, which is desirable for default members. However, unless the prescription is very carefully crafted and detailed it may impose restrictions on funds' benefit design initiatives that many may feel are inappropriate. Care especially needs to be taken with members whose circumstances change dramatically e.g. out of workforce temporarily/drop to part-time hours.

12. How frequently should the assessment of maximum thresholds by a fund be made? Annually? Upon the expiry of premium guarantee periods? Every three years? Whenever prices or automatic insurance levels are changed?

A simple approach would be to build it into the annual review process for funds where it is a particular concern, for all or a subset of the membership. As other analysis is likely to be being carried out at expiry of the rate guarantee or the date of changes to insurance scales or prices, the assessment could be repeated at those times.

For funds where there is no issue for the whole membership, analysis at the date of significant changes would be adequate.

13. Should there be one set of maximums or should they differ between different occupational / age groups?

See response to Question 8.

B.3 Questions

Establish an industry standard for cessation of automatic cover due to low contributions, contributions inactivity or low account balances.

14. Should a Code prescribe cover cessation thresholds?

Having individual funds set their own thresholds allows them to tailor them to their membership but exposes them to the risk of unfavourable attention if their thresholds differ significantly from those of other funds.

Prescribed thresholds are simpler for members to understand as they will apply to all funds.

If tailoring is important to funds, the code could prescribe the most stringent thresholds but allow individual funds to be less stringent should they wish. It would be likely that the majority of funds would adopt the thresholds in the code.

Yours sincerely

Geoff McRae
Senior Consultant & Authorised Representative
Rice Warner Pty Ltd AFSL 239 191