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# Proposed revisions to Prudential Standard SPS 250 Insurance in Superannuation

## ABOUT US

Super Consumers Australia (Super Consumers), formerly known as the Superannuation Consumers' Centre, is an independent, not-for-profit consumer organisation formed in 2013. Super Consumers was first funded in 2018. We work to advance and protect the interests of low and middle income people in the Australian superannuation system.

During its start up phase Super Consumers has partnered with CHOICE to deliver support services. CHOICE is the leading consumer advocate in Australia, established 60 years ago, it is an independent voice, ensuring consumers get a fair go.

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*The Superannuation Consumers' Centre is a not-for-profit company limited by guarantee. ABN 34 163 636 566 ACN 163 636 566*

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## Introduction

Super Consumers Australia welcomes the opportunity to comment on APRA's proposed revisions to the prudential standard governing insurance in superannuation (SPS 250).

Insurance in super is meant to be a safeguard when things go wrong and people can no longer draw income from their usual occupation. Around 12 million people have insurance through their superannuation, with premiums deducted for one or more insurance products from half of all superannuation accounts (and three quarters of MySuper accounts).<sup>1</sup>

As the Productivity Commission found, “there is no specific policy architecture governing how insurance should be delivered to members. Rather, the suitability of arrangements relies on the broad obligations of trustees acting in members’ best interests and some degree of regulatory oversight.”<sup>2</sup>

The available evidence shows that superannuation trustees have failed to act in the best interests of members when it comes to insurance in superannuation. Predictably in this context, insurance matters account for over a third of member complaints against superannuation funds.<sup>3</sup>

Although it is not a comprehensive solution to the myriad of problems with insurance in super that have been amply identified,<sup>4</sup> a stronger prudential standard is clearly desirable.

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<sup>1</sup> Productivity Commission, 2018, ‘*Superannuation: Assessing Efficiency and Competitiveness*’, Report No. 91, p369.

<sup>2</sup> Productivity Commission, op.cit. p374.

<sup>3</sup> The Productivity Commission reported on Superannuation Complaints Tribunal data for 2016-17 (op.cit., p375). More recent AFCA data is comparable, with 35% of the 2,307 complaints about superannuation progressed by AFCA in the period 1/11/18-30/6/19 relating to group life insurance (AFCA Datacube, <https://data.afca.org.au/at-a-glance>, accessed 29/1/20).

<sup>4</sup> Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, 2019, ‘*Final Report: Vol. 1*’ (Royal Commission); Productivity Commission, op.cit; Parliamentary Joint Committee on Corporations and Financial services, 2018, Report: ‘*Life insurance industry*’.

## Summary of Recommendations

**Recommendation 1:** That APRA amend the Prudential Practice Guide supporting Prudential Standard SPS 250 to include a good practice model process that enables beneficiaries to easily opt-out of insurance cover using similar methods to how they signed up for their superannuation account.

**Recommendation 2:** That APRA amend Clause 12(f) to clarify that members should be able to easily opt-out of either all or part of their insurance cover.

**Recommendation 3:** That APRA amend Clause 16 to specify that trustees should be required to annually report why the levels of cover chosen by the trustee are in members' best interests, with reference to the erosive impacts on particular cohorts of members (e.g. women, people with low balances, people across different age demographics). Trustees should also be required to provide on their website a calculator to illustrate how insurance premiums are affecting members' balances.

**Recommendation 4:** That APRA amend Clause 19 to require licensees, in assessing whether attribution of a particular status to a member in connection with insurance is 'fair and reasonable', to have regard to data about their membership. To assist, APRA should develop further guidance in the Prudential Practice Guide.

**Recommendation 5:** That APRA rewrite Clause 24 to state that: "An RSE licensee who enters into an insurance arrangement with a related party, or who gives priority or privilege to an insurer, must obtain independent certification that the arrangement is....(a), (b)."

**Recommendation 6:** That APRA amend Clause 25 to:

- a) require a report of independent certification to be provided to APRA by the author of the report at the same time as it is provided to the RSE licensee.
- b) require an RSE licensee obtaining independent certification to supply APRA with a formal assurance that they have not sought to improperly influence the content of the independent certification or its author.

**Recommendation 7:** That APRA amend Clause 24(d) to direct RSE licensees to a definition of 'priority or privilege' and related guidance in the Prudential Practice Guidance, which APRA should develop.

**Recommendation 8:** That APRA amend Prudential Standard SPS 250 to prohibit trustees from arranging (within a minimum specified period of time) to obtain independent certification from a firm that has been found to have engaged in any kind of administrative or corporate misconduct. APRA should update the Prudential Practice Guide to include relevant guidance

on this point, as well as the need to manage actual or perceived conflicts of interests and not editorially interfere in the independent certification process.

**Recommendation 9:** That APRA capture the potential costs to consumers of not enacting this standard or enacting a version that derogates from what has been proposed.

## Proposed revisions

We note that the proposed revisions to SPS 250 are a ‘first step’ in implementing enhancements identified in APRA’s post-implementation review and recommended by the Royal Commission.

To this end, the draft revised standard require RSE licensees to ensure:

- a process that enables beneficiaries to easily opt-out of insurance cover,
- that the level and type of insurance cover not inappropriately erode the retirement income of beneficiaries,
- that any status attributed to a beneficiary in connection with the provision of insurance is fair and reasonable (Royal Commission recommendation 4.15), and
- independent certification that insurance arrangements are in the best interests of beneficiaries (Royal Commission Recommendation 4.14).

In addition to inviting feedback about whether the proposed revisions to SPS 250 achieve the stated policy intent and other areas where the standard could be improved, we note that APRA is particularly keen to receive submissions on:

1. Aspects of insurance arrangement that may give ‘priority or privilege’ to an insurer, and other areas related to his proposed requirement where guidance in SPS 250 would be helpful.
2. The compliance impact of the proposed changes and any other substantive costs associated with the changes.

Against this background, our observations and recommendations are outlined below. As an overall comment, we note that consequent to any revisions to SPS 250, appropriate guidance will need to be incorporated in the relevant Prudential Practice Guide.

## Opt-out process

Individuals should have the ability to make their own decisions about their insurance needs having regard to their personal circumstances. What is appropriate for a mid-career individual with young children and a mortgage is unlikely to be ideal for a recent graduate who has no dependents and rents.

The Productivity Commission's analysis found that nearly half of the super fund members it surveyed do not find it easy to opt out of insurance cover.<sup>5</sup>

Revised draft SPS 250 requires an RSE licensee's insurance management framework to include "a process that enables beneficiaries to easily opt-out of insurance cover".<sup>6</sup> Given the Productivity Commission's analysis, and the potential for subjective interpretation of 'easily opt out', we recommend that the Prudential Practice Guide be amended to include a good practice model. The Guide should specify that consumers should be able to opt-out using similar methods to how they signed up for the superannuation account (and with that, the default insurance). For example, if the fund offers services online, it should allow consumers to opt-out of insurance online. This approach is consistent with other cancellation requirements for the financial services sector, such as the obligation for credit card providers to offer online cancellation.<sup>7</sup>

The revised draft does not specify that members should be able to opt-out of either all or part of their insurance cover. In some cases members are being denied a choice to opt-out of a specific type of insurance, for example death and total and permanent disability insurance are sometimes bundled together. Without regulatory direction the decision to offer the choice of unbundled cover is left to the trustee and may ultimately be subject to commercial considerations, rather than the best interests of members who wish to choose their cover type. The Productivity Commission noted that giving members a choice would be of likely benefit to many members.<sup>8</sup> We recommend that the Prudential Practice Guide be amended to give this choice.

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<sup>5</sup> Productivity Commission, op.cit., p394.

<sup>6</sup> Clause 12(f).

<sup>7</sup> See obligations introduced in the *Treasury Laws Amendment (Banking Measures No. 1) Bill 2017* [https://www.aph.gov.au/Parliamentary\\_Business/Bills\\_Legislation/Bills\\_Search\\_Results/Result?bld=r5990](https://www.aph.gov.au/Parliamentary_Business/Bills_Legislation/Bills_Search_Results/Result?bld=r5990)

<sup>8</sup> Productivity Commission, op.cit., p393.

## Recommendations:

1. That APRA amend the Prudential Practice Guide supporting Prudential Standard SPS 250 to include a good practice model process that enables beneficiaries to easily opt-out of insurance cover using similar methods to how they signed up for their superannuation account.
2. That APRA amend Clause 12(f) to clarify that members should be able to easily opt-out of either all or part of their insurance cover.

## Retirement income erosion

The SIS Act requires superannuation trustees to only offer insurance that does not inappropriately erode the retirement income of members.<sup>9</sup> This requires trustees to balance two competing interests. As we have previously observed, there is very limited prescription for how trustees should approach this task.<sup>10</sup>

The Productivity Commission found that the deduction of insurance premiums can lead to material and regressive balance erosion, with low income members and those with intermittent labour force attachment and/or multiple accounts with insurance disproportionately affected.<sup>11</sup>

Moreover, as ASIC has recently documented, approaches to balance erosion are inconsistent between funds.<sup>12</sup> While the Voluntary Code of Practice for Insurance in Superannuation requires trustees to set premiums for Automatic Insurance Members at a level that does not exceed 1% of an estimated level of salary for the membership generally, and/or for segments within the membership, trustees use different approaches to calculate this estimated salary. For example, they may base it on:

- salary data the trustee holds for its membership

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<sup>9</sup> s52(7), *Superannuation Industry (Supervision) Act 1993*.

<sup>10</sup> Choice/Superannuation Consumers' Centre, 2018, *'Submission to Royal Commission - Insurance Round'*, p22.

<sup>11</sup> Productivity Commission, *op.cit*, Finding 8.1, p60.

<sup>12</sup> ASIC, 2019, REP 646: *'Insurance in superannuation: Industry implementation of the Voluntary Code of Practice'*, p15.

- data representative of the industry or demographic of the particular fund (e.g. from the Australian Bureau of Statistics or the Australian Taxation Office)
- members' estimated average lifetime earnings and average lifetime income.<sup>13</sup>

The code is also deficient in that it is voluntary, meaning funds may be compliant with parts, the whole or none of the provisions. This has led to the degree of balance erosion across the sector differing significantly between funds. The Productivity Commission reported that for low income people and those with intermittent labour force attachment, retirement balance erosion could reach 14% (\$85,000) and as much as 28% (\$125,000) for some disadvantaged members with duplicate insurance policies.<sup>14</sup>

The Productivity Commission recommended that trustees "should be required to annually articulate the 'balance erosion trade-off' for their members and publish it on their website."<sup>15</sup>

The revised draft SPS 250 proposes a new requirement for an RSE licensee's insurance strategy to document 'specifically how it has confirmed that the level and type of cover will not inappropriately erode the retirement income of beneficiaries'.<sup>16</sup> This requirement falls short of the Productivity Commission's recommendation. Clause 16 should be amended to specify that trustees should be required to annually report why the levels of cover chosen by the trustee are in members' best interests, with reference to the erosive impacts on particular cohorts of members (e.g. women, people with low balances, people across different age demographics). Trustees should also be required to provide on their website a calculator to illustrate how insurance premiums are affecting members' balances.<sup>17</sup>

More broadly however, we agree with ASIC about the need for a standardised approach to the calculation of the 1% premium-salary threshold. We also consider that there should be a role for ASIC to take appropriate regulatory action where there are failures on the part of trustees to appropriately weigh the balance erosion trade-off.<sup>18</sup>

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<sup>13</sup> ASIC, op.cit, p15.

<sup>14</sup> Productivity Commission, op.cit, p19.

<sup>15</sup> Productivity Commission, op.cit., Recommendation 16.

<sup>16</sup> Clause 16(a).

<sup>17</sup> Productivity Commission, op.cit. Recommendation 16.

<sup>18</sup> Choice/Superannuation Consumers' Centre, 2018, '*Submission to Royal Commission - Superannuation Round*', p27.



## Recommendation:

3. That APRA amend Clause 16 to specify that trustees should be required to annually report why the levels of cover chosen by the trustee are in members' best interests, with reference to the erosive impacts on particular cohorts of members (e.g. women, people with low balances, people across different age demographics). Trustees should also be required to provide on their website a calculator to illustrate how insurance premiums are affecting members' balances.

## Attribution of status

The egregious practice of some super trustees applying default settings, such as smoker status or high-risk occupational categories, needs to end. These default classifications are likely to be inappropriate and result in higher premiums for large cohorts of members.<sup>19</sup>

The Royal Commission recommended that SPS 250 be amended to require RSE licensees to be satisfied that the rules by which a particular status is attributed to a member in connection with insurance are fair and reasonable.<sup>20</sup> This recommendation has been incorporated into the revised draft standard.<sup>21</sup>

While we support the new clause, it is imperative that consideration is given to what constitutes 'fair and reasonable', and that this consideration goes beyond a narrow legal interpretation to encompass community expectations, which are likely to be considerably broader. The clause should be amended to require licensees to assess whether attribution of a particular status is 'fair and reasonable' having regard to guidance contained in the Prudential Practice Guide, which APRA should develop.

There would also be merit in amending clause 19 by adding that, in satisfying themselves that a particular status attributed to a member in connection with insurance is fair and reasonable, licensees must show how they have had regard to data about their membership. This would provide an incentive for funds to collect better quality data.

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<sup>19</sup> ASIC, 2018, REP 591: *'Insurance in Superannuation'*, p17.

<sup>20</sup> Recommendation 4.15.

<sup>21</sup> Clause 19.

On this point, it is apparent that few funds appear to collect sufficient data to properly understand their members' characteristics and needs.<sup>22</sup> This is inextricably linked to the question of how funds can meet their legal obligation to act in the best interest of their members. To this end we have previously recommended that, at a minimum, funds should be administering regular member surveys to collect data about the characteristics and needs of beneficiaries.<sup>23</sup> It is worth also noting that the Senate is exploring the option of expanding open data to superannuation, which would allow people to easily share their super data, creating a more pro-consumer market, but would also be likely to assist funds to build better profiles of their membership.

### Recommendation:

4. That APRA amend Clause 19 to require licensees, in assessing whether attribution of a particular status to a member in connection with insurance is 'fair and reasonable', to have regard to data about their membership. To assist, APRA should develop further guidance in the Prudential Practice Guide.

## Independent certification

As the well publicised cases of Colonial First State (CFS) and AMP demonstrate, serious conflicts of interest can arise when RSE licensees use a related party to provide insurance.<sup>24</sup> The Royal Commission found that entities in this position of conflict "can reasonably, and should, be subjected to a higher degree of regulatory scrutiny".<sup>25</sup>

CFS conducted an independent benchmarking review of its insurance offering, which at the time was provided by a related entity, CommInsure. Despite the review showing that the group insurance product performed poorly when compared to the market, CFS continued the insurance arrangement. In effect, CFS placed the interests of CommInsure above the interests of its fund members.<sup>26</sup> Super Consumers Australia has also been vocal in our concern about

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<sup>22</sup> Choice/Superannuation Consumers' Centre, 2019, '*Submission to the Treasury on Making Industry Codes Work*', p5; APRA, 2019, '*Information Paper: Review of APRA's 2013 superannuation prudential framework*', p39; Productivity Commission, op.cit., pp.28-29.

<sup>23</sup> Super Consumers Australia, 2019, '*Submission to APRA on Revised SPG 516: Business Performance Review*', Recommendation 9.

<sup>24</sup> Royal Commission, op.cit., p326.

<sup>25</sup> Royal Commission, op.cit., p327.

<sup>26</sup> Choice/Superannuation Consumers' Centre, 2018, '*Submission to Royal Commission - Superannuation Round*', pp.21-22.

claims processing delays where AMP is both the superannuation trustee, and the insurance provider.<sup>27</sup>

Consistent with the Royal Commission's recommendation,<sup>28</sup> the revised standard now requires an RSE licensee to:

“obtain independent certification that an insurance arrangement, or any other arrangement entered into in relation to the provision of group insurance:

- (a) is in the best interests of the beneficiaries; and
- (b) otherwise satisfies all applicable legal and regulatory requirements, where the insurance arrangement or other arrangement or other arrangement:
- (c) is with a related party insurer; or
- (d) gives priority or privilege to an insurer.”<sup>29</sup>

The RSE licensee must provide the independent certification to APRA promptly (within five days) and not less than one calendar month before entering into a new insurance arrangement, or renewing an existing arrangement. If the insurance arrangement is for a term of, or exceeding, three years, the certification must be provided to APRA on a biennial basis.<sup>30</sup>

Independent certification should not be regarded as a silver bullet to deal with conflicts of interests.<sup>31</sup> As a for-profit component of a superannuation product, which is already poorly understood and lacking member beneficial competition, insurance in superannuation is ripe for a thorough analysis of any conflicts driving arrangements, competition and efficiency in how it is delivered. It is one thing for APRA to be provided with an independent certification, but another thing for it to critically examine reports and hold trustees to account against their conclusions. This raises a necessary question, what clarity and assurances will APRA provide about its plans to verify the information contained in these independent reports?

Notwithstanding the qualifying comments above, the requirement for trustees to obtain independent certification represents a step in the right direction and we have identified opportunities to strengthen it by amending clause 24 of the revised draft code:

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<sup>27</sup> Super Consumers Australia, 2019, Media release: *'Please explain: AMP claims handling delays'*.

<sup>28</sup> Recommendation 4.14.

<sup>29</sup> At clause 24.

<sup>30</sup> i.e every two years.

<sup>31</sup> Choice/Superannuation Consumers' Centre, 2018, *'Submission to Royal Commission - Superannuation Round'*, pp.21-22.

## Applicability of requirement

Clause 24 is applicable to an RSE licensee who enters into an insurance arrangement or other arrangement with a related party insurer, or gives priority or privilege to an insurer. This is not as clear as it could be from the current wording of the clause. In the interests of clarity, we recommend that it be re-written to state that “An RSE licensee who enters into an insurance arrangement with a related party, or who gives priority or privilege to an insurer, must obtain independent certification that the arrangement is....(a), (b).”

## Contemporaneous provision of independent reports and confirmation of integrity

The Royal Commission’s related commentary on Recommendation 4.14 highlighted that:

“The independent report should also be provided to APRA by the author of the report at the same time as it is provided to the RSE licensee. The contemporaneous provision of the report will allow APRA to form a view more quickly on the appropriateness of the arrangement and to take such action as it thinks necessary, including by referring the matter to ASIC, so that it can take action to protect the interests of members.”<sup>32</sup>

‘Contemporaneous provision’ is not required by clause 25 of the revised draft standard and should be for the reasons articulated above.

Further, the AMP example uncovered by the Royal Commission illustrates the temptation for trustees to interfere in the ‘independent’ reporting process, thereby fundamentally compromising its integrity. RSE licensees should be required to supply APRA with a formal assurance that they have not sought to improperly influence the content of the independent certification or its author. On this point, the Prudential Practice Guide should be updated to make clear that the independent certification process must not involve editorial interference by trustee board or management.

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<sup>32</sup> Royal Commission, op.cit., p.328.

## Definition of ‘priority or privilege’

‘Priority or privilege’ as it relates to an insurer is not defined by SPS 250, nor is any related guidance given in the Prudential Practice Standard. We understand the need for the widest possible definition to capture any behaviour which may lead to conflicts, but see value in giving trustees greater direction as to the type of behaviour that may be captured. This gap should be rectified having regard to relevant observations by the Royal Commission, Productivity Commission, ASIC and APRA.

## Probity in relation to the selection of firms to undertake independent certification

Probity in relation to trustees’ selection of firms to undertake independent certification is not addressed in the draft revised standard. For obvious reasons, only reputable firms should be engaged by trustees. We recommend that the draft standard be amended to prohibit trustees from arranging (within a minimum specified period of time e.g. two years) to obtain independent certification from a firm that has been found to have engaged in any kind of administrative or corporate misconduct. The Prudential Practice Guide should also be updated to incorporate relevant supporting guidance.

### Recommendations:

5. That APRA rewrite Clause 24 to state that: “An RSE licensee who enters into an insurance arrangement with a related party, or who gives priority or privilege to an insurer, must obtain independent certification that the arrangement is...(a), (b).”
6. That APRA amend Clause 25 to:
  - a) require a report of independent certification to be provided to APRA by the author of the report at the same time as it is provided to the RSE licensee.
  - b) require an RSE licensee obtaining independent certification to supply APRA with a formal assurance that they have not sought to improperly influence the content of the independent certification or its author.

7. That APRA amend Clause 24(d) to direct RSE licensees to a definition of 'priority or privilege' and related guidance in the Prudential Practice Guidance, which APRA should develop.
8. That APRA amend Prudential Standard SPS 250 to prohibit trustees from arranging (within a minimum specified period of time) to obtain independent certification from a firm that has been found to have engaged in any kind of administrative or corporate misconduct. APRA should update the Prudential Practice Guide to include relevant guidance on this point, as well as the need to manage actual or perceived conflicts of interests and not editorially interfere in the independent certification process.

## Compliance impact

We note that in addition to feedback about the compliance impact of the proposed changes, APRA has sought information about 'any other substantive costs associated with the changes'. Industry will no doubt have much to say about this. As our primary function is to protect the interests of superannuation consumers, we would expect APRA to take steps to quantify and consider the potential burden on consumers if the proposed changes are not adopted, or are watered down. While arguably more difficult to calculate than the cost to industry, an understanding of this burden is essential to an informed discussion.

As a starting point APRA should seek to quantify the costs to consumers of being bundled into insurance products that are not competitive with other market offers on the basis of key terms, premiums and benefits.

### **Recommendation:**

9. That APRA capture the potential costs to consumers of not enacting this standard or enacting a version that derogates from what has been proposed.

## Additional comments

While offering our observations and recommendations on the proposed changes to SPS 250 in good faith, we reiterate our position that an independent inquiry into insurance in super, as

recommended by the Productivity Commission, remains necessary to comprehensively consider a range of issues, including (but not limited to) the prudential framework and regulatory issues more broadly.