3 February 2020

[redacted]
Australian Prudential Regulation Authority
GPO Box 9836
SYDNEY NSW 2001

Email: [redacted]

[redacted]

Proposed changes to Prudential standard SPS 250 Insurance in Superannuation

On 25 November 2019, APRA released a consultation paper regarding changes to SPS 250 Insurance in Superannuation, as the first step in implementing the enhancements identified in APRA's Post-Implementation review and addressing the relevant recommendations of the Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry in relation in the provision of insurance in superannuation

The Actuaries Institutes supports the intent and spirit of the changes and welcomes the opportunity to provide feedback on the proposed revisions.

Some changes replicate the Royal Commission recommendations including use of its terminology. The Actuaries Institute believes it would be more helpful for Trustees and members if the changes use terminology already understood and part of the superannuation environment, rather than introducing new terms and concepts that will be open to wide and inconsistent interpretation and may result in unintended consequences. This would give effect to the intent of the Royal Commission recommendations without the downside of making the superannuation environment more complex.

The Actuaries Institute also believes that some of the changes in respect of status are impractical or will come at a very high cost to Trustees (and ultimately members) if Trustees are not given access to the necessary data and information (such as occupation and employment status) that is required to implement the change. These changes should only come into effect when they can be implemented effectively and efficiently. This can be achieved either through:

- access to occupation data held by the Australian Taxation Office; or
- modification to SuperStream for example by standardising the occupation field and making it a compulsory field rather than a voluntary field. Similarly, for the fields for employment dates. This is particularly relevant in relation to the correct occupational classification of the member where currently this information is difficult for Trustees to obtain at the point when the member joins the fund and on an on-going basis as few members provide this data when Trustees communicate with them.

Specific feedback on each of the proposed changes to SPS 250 has been provided in Schedule 1.

Institute of Actuaries of Australia
ABN 69 000 423 656
Level 2, 50 Carrington Street, Sydney NSW Australia 2000
t +61 (0) 2 9239 6100 f +61 (0) 2 9239 6170
e actuaries@actuaries.asn.au w www.actuaries.asn.au

Thank you for the opportunity to contribute to these important changes to SPS 250. We would welcome the opportunity to meet with you if you would like to discuss any of our recommendations. Please contact the Actuaries Institute CEO, [redacted] if you have any questions regarding our submission.

Yours sincerely

[redacted]

President

Schedule 1

Proposed change in red	Submission to APRA
New 12 f) a process that enables beneficiaries to easily opt-out of insurance cover.	The Institute agrees that the provision of a mechanism for members to opt-out of insurance cover easily will assist in mitigating the risk of members holding unwanted insurance cover which may ultimately erode their retirement benefits. We note that many Trustees already do this. However, we are also of the view that, ideally, members should make this decision with full awareness of: • the potential impact of opting out of insurance cover on the member's ability to obtain insurance cover in the future; and • the process of reapplying for insurance cover and the potential need to provide evidence of good health including through an underwriting process. This is particularly relevant under the Putting Members' Interests First legislation (PMIF) legislation where new members must opt in for cover and it may not be in their best interest to opt out of their existing cover until their new cover is provided without restriction. **Recommendation** We would propose the following amendment to the new 12 (f): *f) a process that enables beneficiaries to easily opt-out of insurance cover and which provides them with information about the impact of opting out of cover, including their ability to obtain cover in the future.*

Proposed change in red	Submission to APRA
Change to paragraph 14: An RSE licensee must maintain records of sufficient detail to comply with its obligation under the prudential framework and for a prospective insurer to properly assess the insured benefits that are made available. These records must include, for at least the previous five years, the claims experience, membership, sum insured and premiums paid in relation to beneficiaries.	We understand that the additional wording under this paragraph is in contemplation for a proposed Data Transformation Project which will require Trustees to maintain additional information and, in some cases, provide this information to APRA. While the existing paragraph 14 provides a succinct summary of the current requirements i.e. for a prospective insurer to properly assess the insured benefits that are made available, there is concern that as the prudential framework is extensive and includes a number of documents, this may be difficult for Trustees to form a comprehensive view of all the requirements for data retention across APRA's prudential framework. There is also concern that the introduction of new data requirements will involve extensive changes to data collection and administration systems. Paragraph 14 should also be clarified to make it clear that maintaining records includes records stored by the administrator or the insurer on the Trustee's behalf. This allows the Trustee to determine the most efficient data storage processes, efficiency which will flow back to members' accounts through a lower cost base and enhance their retirement incomes. **Recommendation** The Institute proposes that APRA: • Allows Trustees a transitional period to enable Trustees to amend data collection and administration systems to comply with the additional data requirements; • Provides an overarching summary of all the data retention requirements affecting a Fund's insurance offering; and • Replace "maintain records" with "maintain or have access to records".
Change to paragraph 16 (a): how the RSE licensee has regard to each of the factors in section 52(7) of the SIS Act, and specifically how it has confirmed that the level and type of cover will not inappropriately erode the retirement income of beneficiaries;	The changes to paragraph 16 (a) do not introduce a new requirement but reinforce the current obligations of the Trustee under section 52(7) of the SIS Act to: *(b) to consider the cost to all beneficiaries of offering or acquiring insurance of a particular kind, or at a particular level;* *(c) to only offer or acquire insurance of a particular kind, or at a particular level, if the cost of the insurance does not inappropriately erode the retirement income of beneficiaries.*

Proposed change in red	Submission to APRA
	Trustees are required to determine their own tolerance levels for the effect of insurance premiums on members' retirement benefits. Trustees will also determine if as a result of the breaching of these tolerance levels, there will be a need to reduce sums insureds or amend terms to reduce members' eligibility for benefits. It is also important that the Trustee consider qualitative measures to ensure that members do not retain unnecessary insurance; e.g. retirees who are no longer working but who retain TPD or Income Protection cover. One of the effects of the Protecting Your Super legislation (PYS) and the Putting Members' Interests First legislation (PMIF) has been to increase insurance premium rates for members in order to meet the cost of structural changes, ongoing anti selection and the initial cost of anti-selection from existing members whose cover is turned off under PYS or PMIF and who opt back in. These increased premium costs and fixed administration costs are spread over a smaller insured membership which also has the effect of increasing premium rates. While the Institute does not recommend any change to the proposed paragraph 16 (a) revision, we welcome the opportunity to engage with APRA on the provision of guidance for Trustees in the determination and management of this tolerance level and the various criteria and benchmarks that may be appropriate in the light of: • The effect of PYS and PMIF on insurance premiums overall; and • The Dangerous Occupation exception.

New paragraph 19: Any status attributed to a beneficiary (including a class or cohort of beneficiaries) in connection with the provision of insurance must be fair and reasonable.	**Royal Commission Recommendation** The Royal Commission recommendation was in relation to the "rules by which a particular status is attributed to a member in connection with insurance are fair and reasonable." APRA, by requiring this test to apply to the status rather than the rules, is requiring a more onerous and less practical requirement on Trustees. **Recommendation** The Institute recommends that APRA revert to the wording recommended by the Royal Commission, so for example paragraph 19 would read: *The rules by which a status is attributed to a beneficiary (including a class or cohort of beneficiaries) in connection with the provision of insurance must be fair and reasonable.* **APRA Wording** If the proposed wording is retained, the changes are impractical or will come at a very high cost to members if Trustees are not given access to the data and information required to implement the change, in particular, occupation and employment status information for each member. These changes should only come into effect when they can be implemented effectively and efficiently. We have suggested below a number of clarifications that will assist in protecting members and also assist Trustees in implementing these changes. **Interpretation of "status"** We note that the new paragraph 19 refers to: *any status...in connection with the provision of insurance.* The following are some of the common factors that a Trustee may use in the determination of premiums and/or sum insured and/or eligibility for cover for beneficiaries: • Occupational category e.g. Professional, white collar, manual; • Employment status e.g. full-time, part-time, retired, unemployed, permanent/casual; • Gender e.g. male, female or unisex; • Smoker or non-smoker status; and • Age Occupational category is an integral component in group insurance pricing and in the application of the "dangerous occupation" exception. While in some cases Trustees can obtain this information through

	the member application process and through regular targeted communication to members, the majority of members join through SuperStream and do not respond to additional information requests. Our cover letter suggested a relatively straightforward change to the data available to Trustees that would provide a solution to this issue. **Recommendation:** If APRA does not revert to the wording recommended by the Royal Commission, the Institute recommends that APRA provide greater clarity regarding the interpretation of the word status in the context of the new paragraph 19. This will assist in the interpretation and implementation of this change. **Interpretation of "Fair and Reasonable"** Pricing in all insurance is based on the concept of pooling risk. All members of the pool will not be exposed to exactly the same level of risk, but all members of the pool benefit by from the protection provided by the pool. This concept aligns to Trustees acting in the collective best interests of all their members, providing fairness in pricing for the group as a collective and delivering the benefits of group insurance in the most efficient and effective way. It is not aligned to treating each individual member with absolute fairness based on a concept that the risk level of each member is able to be determined for them individually based on full knowledge of their personal risk characteristics and an adjustment to their premium determined. It would create significant and costly inefficiencies if it was attempted. Even in individual insurance this is not attempted. Whilst fairness can be defined to be "acceptable and appropriate in a particular situation; everyone involved being treated equally and reasonably", it can also be defined as fair for an individual member and their specific circumstances. Trustees have limited information about each member making it impossible to design insurance arrangements that fit an individual member's circumstances, outside the data available to the Trustee such as age. Without clarity, of the proposed fair and reasonable status requirement, Trustees may face complaints and legal challenges.

	Notwithstanding our comments regarding the interpretation of "Fair" in a pooled group arrangement outlined above, the following factors could be taken into account in forming a view that the segmentation of the membership for insurance pricing purposes or allocation of status to a member is "fair and reasonable": • The use of actuarial data on risks associated with different occupational categories; • In mixed membership cohort, the ability to assume that members are classified in line with the majority of the members' occupational category or in line with an occupation rating associated with their employer; • Data and information that is efficiently available to Trustees. It may be inappropriate for Trustees to spend large amounts of members' money chasing down those members who do not respond to communication material. The concept of what is fair and reasonable can also be extended to assessing the extent to which the Trustee is engaging directly with members to obtain an accurate reflection of their status and how pro-active should the Trustee be in obtaining this information. **Recommendation** As the term "fair and reasonable" can be open to wide and inconsistent interpretation, we recommend that APRA replace it with current terminology (members' best interests). The Institute further recommends that, if "fair and reasonable" is retained, APRA includes a clear and comprehensive definition within SPS 250 to avoid uncertainty and potentially a new avenue for litigation. This would provide clarity within SPS 250 to Trustees in relation to the interpretation of "fair and reasonable", and should address the additional cost burdens this may imply that have to be met by all members and the extent that APRA expects Trustees to go to obtain missing data from members and employers and appropriate default positions where this data is not provided. The Institute would be happy to meet with APRA to discuss how this term could be clarified. **Clarify that status includes change in status** While the initial status of a member is important in relation to the calculation of premiums and/or sum insured, it is important to note that in some cases, a member's insurance status is changed when a member:

Proposed change in red	Submission to APRA
	• Moves from an employer sponsored arrangement to a preserved or personal arrangement in the same fund or • Moves from one employer to another employer in the same fund. The Trustee should allocate members to the most appropriate status based on the data available to them at the time of joining and also throughout their membership in a particular fund. **Recommendation** We recommend adding the words: *or change in status.*

New paragraph 24 and 25 24. An RSE licensee must 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: (c) is with a related party insurer; or (d) gives priority or privilege to an insurer. 25. An RSE licensee that is required to obtain independent certification under paragraph 24 must provide the certification to APRA within five business days of its receipt by the RSE licensee and no later than one calendar month prior to the RSE licensee: (a) entering into a new insurance arrangement; or	The Institute notes that the introduction of paragraphs 24 and 25 are in response to concerns raised in the Royal Commission that members may be disadvantaged by conflicts which may arise where the provision of insurance is through a related party or under arrangements that provide priority or privilege to an insurer. The requirements for Trustees to act in the best interests of beneficiaries and to satisfy all legal and regulatory requirements is an obligation on all Trustees regardless of the structure of the insurance arrangement it has in place. New paragraphs 24 and 25 add a requirement that in some situations a Trustee will be required to go further and obtain independent certification of the arrangement. The Institute believes there may be an opportunity for APRA to improve SPS 250 further in relation to certification generally and the interaction of this section with the independent review of the Insurance Management Framework. There has not been time to finalise our proposals in this area. The Institute is happy to meet with APRA to discuss this or to provide our suggestions in a round 2 submission if APRA requests this. **Certification** There are a number of issues with the proposal: a) what will happen if the Trustee can't obtain certification as there will be no time available to conduct a market tender or for the Trustee to consider the changes required to meet the certifier's view. It would be unreasonable presumably for the Trustee to remove all cover for its members even if the arrangement could not be certified. b) It is not clear that the best interest certification is possible. For example, in any review and tender (insurance or otherwise) there are often issues and possible improvements identified that are not able to be addressed and are put on the list to look at 'next time'. It is unclear why the certifier is described as "independent" while the reviewer required for the Insurance Management Framework every 3 years is described as "operationally independent, appropriately trained and competent". These two terms have separate meanings and could influence who is allowed to provide the certification/review. It may be that APRA wishes to hold the certification to a higher

(b) renewing an existing insurance arrangement. If an insurance arrangement is for a term of, or exceeding, three years, the certification must be provided to APRA on a biennial basis. The new paragraphs 24 and 25 and then supported by a new 18 (n) which deals with the minimum requirements in an insurance arrangement. (n) the RSE licensee's right to terminate the insurance arrangement, should an independent certification received under paragraph 24 be negative.	independence standard than the review. Unless APRA sees a reason to distinguish between these functions we suggest a consistent description be adopted. **Insurance arrangement, or any other arrangement entered into in relation to the provision of group insurance** The word "arrangement" is very broad, and the certification is potentially very onerous. It arguably includes for example: • The benefit design, particularly the default design and level of premium and choice of rating factors • Eligibility conditions • Premium recovery system • Experience rebate conditions • Definitions of key terms such as disability definitions • Exclusions • Automatic cover limits and terms • Equity between different groups • Risk control measures • Balance between automatic cover and underwriting, • Equity between different groups • Balancing simplicity and equity. • Claims management and philosophy The certification appears to overlap the independent review of the Insurance Management Framework. Would it be better to limit the certification to the appointment and continued appointment of the related party (or the giving and continued giving of priority or privilege) rather than certifying the whole "arrangement" much of which may not change if a different insurer was appointed, and may already be part of the independent review of the Insurance Management Framework? **The requirement to satisfy "all applicable legal and regulatory requirements"** This requirement for the certification to not only satisfy the best interests of beneficiaries test but also "all applicable legal and regulatory requirements" will be problematic as only a legal practitioner can certify that all legal requirements have been met and the certification regarding regulatory requirements is

within the scope of superannuation fund audit requirements. Any legal certification would be costly and outside the scope of a "best interests of beneficiaries" assessment.

What due diligence is required for this part of the certification? For example, does it require the person to check that all the data and processes required to administer the arrangements and meet APRA reporting requirements are properly catered for? Does it require the person to agree that all the Trustee's decisions about the allocation of statuses to various members are fair and reasonable and that there are no members for whom the insurance arrangements inappropriately erode members' accounts?

Recommendation

We recommend that "all applicable legal and regulatory requirement" be deleted but that the requirement to satisfy regulatory requirements be instead included in a more relevant prudential standard, for example covering audit requirements.

Clarity in relation to the wording of paragraphs 24

The Institute notes that the meaning of paragraph 24 is open to interpretation due to the placement of 'where the insurance arrangement or other arrangement' within (b), in conjunction with the numbering of the subsequent provisions as (c) and (d).

Recommendation

The Institute recommends that in order to avoid the need for interpretation that paragraph 24 be reworded as follows:

An RSE licensee who enters into an insurance arrangement that is either with

i. a related party insurer; or

ii. gives priority or privilege to an insurer;

must obtain independent certification that the arrangement is in the best interests of the beneficiaries.

Paragraph 25 - Interpretation of *"entering into"* an insurance arrangement

The Institute notes that a Trustee can maintain an insurance arrangement which enables premiums to be increased and/or terms and conditions amended without the need to enter into another

	arrangement. As a result, the protections for members that is envisaged through paragraphs 24 and 25 may not occur. **Recommendation** We note that the intention of the changes is to ensure that the insurance arrangement is in the best interests of beneficiaries. As a result, we recommend that the words: *"entering into"* an insurance arrangement be amended to *"entering into or making a material change to the insurance arrangement including but not limited to premiums, cover or terms and conditions".* **Term of an insurance arrangement** The Institute notes that there is a very wide range of "terms" for insurance arrangements, including in many cases guarantees that apply for three years and three years is also the period for the review of the Insurance Management Framework. A consistent approach in line with industry practice would be practical. **Recommendation** To reflect industry practice, we recommend that the wording: *If an insurance arrangement is for a term of, or exceeding, three years, the certification must be provided to APRA on a biennial basis.* Be amended to: *If an insurance arrangement is for a term exceeding three years, the certification must be provided to APRA on a triennial basis.* **Application outside Group Insurance** We note that the changes to SPS 250 in relation to related party transactions are specifically for group insurance. However, Trustees can have arrangements in place where advisers employed by a related party to the insurer can establish individual insurance policies for members through a Trustee arrangement. We note that the same conflicts apply as with related party group insurance arrangements established by a Trustee and the changes will not protect members who come under this arrangement. While we note that FASEA does impose obligations on advisers, it does not extend to Trustees who participate in these arrangements.

Recommendation

In order that the related party arrangements provide the greatest protections for members where there are conflicted arrangements, we recommend that the impact of scope of the changes to SPS 250 be considered in the context of individual insurance policies for members through a Trustee arrangement insured through a related insurer. We further recommend that APRA address this issue in SPS 250 to protect members.

Interpretation of *"related party" in relation to the definition of "related body corporate"*

In SPS250, "related party" is not a defined term and would be open to interpretation particularly in situations where there is only a minor shareholding in the insurer.

We note that in footnote 4 of SPS 250, a related body corporate is defined as having the meaning given in section 50 of the Corporations Act 2001.

> *For the purposes of this Prudential Standard, a reference to 'a group' is a reference to a group comprising the RSE licensee and all connected entities and all related bodies corporate of the RSE licensee, 'connected entity' has the meaning given in section 10(1) of the SIS Act and 'related body corporate' has the meaning given in section 50 of the Corporations Act 2001.*

It is uncertain in the current wording of paragraph 24, if the term "related party" has the same meaning as "*related body corporate*"' in section 50 of the Corporations Act 2001.

Recommendation

In order to ensure that the term "related party" is not open to interpretation, the Institute recommends that:

- If it is intended to be in line with the definition of "*related body corporate*"' in section 50 of the Corporations Act 2001 that this be explicitly stated; or
- If it is intended that a different definition be adopted, that "*related party*" be defined in SPS 250.

Interpretation of *"priority or privilege"*

SPS 250 introduces the new concept of "priority or privilege" which is open to a wide interpretation. At one extreme, all contracts provide priority to the contracted party. That is the purpose of the contract. Under this interpretation APRA is requiring all arrangements to come under paragraph 24 certification. At the other extreme is perhaps an implied test against some notion of standard market practice. This is

	vague and may capture arrangements that are not envisaged by the Royal Commission as requiring certification. A tender that was not sent to all insurers (life and general) in the group market may be considered to provide a priority or privilege to those it was sent to and therefore the selected insurer. Is this intended to be caught up in the certification requirement? The Institute notes that it was not feasible for Trustees, in the timeframes provided by the legislation, to market test PYS or PMIF pricing provided by the incumbent insurer. Under an interpretation of the proposed requirement certification, may have been required of the whole insurance arrangement when these changes were introduced. A tender that was not sent to all insurers in the group market would provide a priority or privilege to those it was sent to. Is this intended to be caught up in the change? The certification is very comprehensive and costly, and the costs will ultimately be met by members. In these circumstances it is important that the certification is only required where it is necessary. The Royal Commission was presumably trying to pick up those arrangements that were in effect similar to a related party arrangement and subject to potential conflicts or a failure to test on an ongoing basis the member best interest. **Recommendation** To assist Trustees to determine the applicability of paragraph 24 and 25, the Institute recommends that the term "priority or privilege" be replaced with the specific circumstances that constitute an insurance arrangement which gives *"priority or privilege"* or that this be more clearly defined. The Institute would be happy to meet with APRA to discuss how this term could be defined.