

[REDACTED]  
Acting General Manager, Policy Development  
Policy and Advice Division  
Australian Prudential Regulation Authority (APRA)  
GPO Box 9836  
Sydney NSW 2001

Sent via email to [superannuation.policy@apra.gov.au](mailto:superannuation.policy@apra.gov.au)

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## **Consultation: Proposed revisions to SPS 250 - Mercer Submission**

Thank you for the opportunity to provide comment on the proposed revisions to *Superannuation Prudential Standard SPS 250 Insurance in Superannuation* (SPS 250).

The proposed revisions include:

- (i) responding to the Hayne Royal Commission recommendation 4.14 to require independent certification that insurance arrangements are in the best interests of beneficiaries and otherwise satisfy all applicable legal and regulatory requirements where the insurance is with a related party or 'the insurer is given a priority or privilege in connection with the provision of life insurance'
- (ii) responding to the Hayne Royal Commission recommendation 4.15 that *the rules* by which a particular status attributed to a beneficiary in connection with the provision of insurance is fair and reasonable
- (iii) requiring funds to have a process that enables beneficiaries to easily opt-out of insurance cover
- (iv) requiring trustees to document how they have confirmed that the level and type of insurance cover do not inappropriately erode the retirement income of beneficiaries.

Mercer is comfortable with proposed revisions (iii) and (iv) as drafted. However, we have concerns with the proposed revisions relating to (i) and (ii).

We have set out these concerns below and in the Appendix.

## 1. Proposed independent certification requirement

Our detailed comments and recommendations regarding the proposed independent certification requirement are set out in the Appendix to this letter. We have numbered our specific recommendations in the Appendix 1 through to 11. Our key recommendations are:

- (1) to clarify when an independent certification is required and to reduce the likelihood of certifications being required inappropriately or 'out-of-sync' with rate reviews:

### **Recommendation 4**

*We recommend certification be required of a contract before it is entered into and at least each 3 years where the contract term exceeds 3 years. If certification is also to be required before 'renewal' then 'renewal' should be clearly defined.*

### **Recommendation 9**

*We recommend clarifying the 'priority or privilege requirement' by modifying to 'the insurer is given a priority or privilege **that would be considered to be out of line with arm's length market practice**' and that, to guide industry participants, the updated SPG 250 should provide some non-exhaustive examples of what "priorities or privileges" would come within the provision.*

### **Recommendation 10**

*We recommend that either SPS 250 or the related SPG make it clear that entering into a contract with the predecessor fund insurer in connection with an SFT to secure equivalency of insurance rights in respect of transferring member benefits would not be regarded as a situation requiring certification.*

- (2) to address concerns that it will be problematic for certifications to be provided in the terms as drafted:

### **Recommendation 5**

*Given the problems with a 'members' best interests' certification, we recommend that the certification be re-framed to be directed at assessing whether the arrangement is reasonably considered to be market-competitive (or on arm's length terms) and, in the certifier's opinion, reasonable for a Trustee to consider in beneficiaries' best interests.*

### **Recommendation 6**

*We recommend the second limb of the certification (satisfies all applicable legal and regulatory requirements) be removed.*

### **Recommendation 7**

*If Recommendation 6 is not accepted, we recommend that, to reduce the cost and appropriately target the certification, the final SPS 250 specifies the particular legal and regulatory requirements that the certification is required to cover.*

- (3) to clarify who can provide an independent certification:

**Recommendation 11**

*We recommend the 'independent certification' wording of draft para 24 be amended to at least align with the para 27 wording of 'operationally independent, appropriately trained and competent persons'*

**2. Proposed requirement that any status attributed to a beneficiary in connection with the provision of insurance is fair and reasonable**

Our concerns regarding this proposal fall in two areas.

Firstly, we think that the intention of the proposed new requirement would be clearer if, as set out in Hayne recommendation 4.15, it required 'the rules by which a particular status is attributed to a beneficiary in connection with the provision of insurance' to be fair and reasonable rather than omitting the reference to 'the rules' as per the consultation draft SPS 250 para 19.

As well as better aligning with Hayne recommendation 4.15, we think expressing the requirement in terms of 'the rules by which a particular status is attributed...' would reduce the potential for complaints that the attributed status was wrong and so could not be fair and reasonable, even if the rules for attributing the status were fair and reasonable (e.g. the person's occupation was eligible for the lower premium 'Professional' classification but because it had no occupational information the trustee attributed the member to the default 'General' classification).

**Recommendation 12**

*We recommend that the wording of draft para 19 be amended to require **'the rules by which a particular status is attributed to a beneficiary in connection with the provision of insurance'** to be fair and reasonable rather than requiring that **'any status attributed to a beneficiary ... must be fair and reasonable'**.*

Secondly, we are concerned about the potential for 'interpretation creep' in regard to what might be considered a 'status' that is covered by the new fair and reasonable requirement:

- (1) In the discussion leading up to recommendation 4.15, the Hayne report says:

*Trustees must be required to make proper arrangements about the premiums that will be charged to default members. That can be achieved by APRA amending SPS 250 to require that any status attributed to default members (such as 'blue-collar', 'smoker', or other status affecting the premium to be charged for insurance) is fair and reasonable. Ordinarily that would require consideration of whether the status attributed is statistically appropriate.*

- (2) It seems clear from this that the recommendation was directed at 'attributed status affecting the premium charged to a member'. Does APRA intend that the new SPS 250 requirement should be limited to status affecting premiums charged?



### **Recommendation 13**

- *If APRA intends that the new SPS 250 requirement should be limited to status affecting premiums charged, we suggest that SPS 250 should include this limitation.*
  - *If APRA intends that the new requirement apply more widely than premium impact, we request that APRA indicate the other areas that trustees will need to consider.*
- (3) In considering whether the rules by which a particular status is attributed to a beneficiary in connection with the provision of insurance are fair and reasonable, we believe it is critical that the factors permitted to be taken into account include:
- what cover terms the insurer/insurance market is willing to provide
  - the information available to the trustee
  - the nature of group insurance, in particular that for efficiency group ratings apply with most members not required to provide additional information or be individually underwritten
- (4) In regard to the terms on which insurers are prepared to provide cover, we note that SIS s68AA (which sets out provisions requiring default Death and TPD cover for MySuper members) allows the trustee to determine reasonable conditions to which the provision of cover is subject, and specifies that conditions determined for this purpose 'are reasonable if they are the same as the terms and conditions of the policy of insurance taken out to provide the benefit'.

### **Recommendation 14**

*We recommend that APRA considers whether a similar 'deeming provision' may be required in order to make the proposed 'fair and reasonable' attributed status requirement workable.*

## **Who is Mercer?**

Mercer is one of the world's leading firms for superannuation, investments, health and human resources consulting and products. Across the Pacific, leading organisations look to Mercer for global insights, thought leadership and product innovation to help transform and grow their businesses. Supported by our global team of 22,000, we help our clients challenge conventional thinking to create solutions that drive business results and make a difference in the lives of millions of people every day.

Mercer Australia provides customised administration, technology and total benefits outsourcing solutions to a large number of employer clients and superannuation funds (including industry funds, master trusts and employer sponsored superannuation funds). We have over \$150 billion in funds under administration locally and provide services to over 2.4 million superannuation members and 15,000 private clients. Our own master trust in Australia, the Mercer Super Trust, has around 230 participating employers, around 240,000 members and more than \$24 billion in assets under management.

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Yours sincerely

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**Manager, Research & Policy**

## Appendix – Comments on proposed independent certification requirements

This Appendix sets out our comments and recommendations regarding the draft amendments to SPS 250 relating to the proposal to require independent certification that insurance arrangements are in the best interests of beneficiaries where the insurance is with a related party or ‘the insurer is given a priority or privilege in connection with the provision of life insurance’.

<p>A.1 Para 24 and 25 draft wording, frequency/ timing of required certifications</p>	<p><b>Recommendation 1</b> Para 24 punctuation needs to be fixed so that the intended meaning is clear.</p> <p><b>Recommendation 2</b> Para 24 should also refer to an arrangement ‘entered into <b>or proposed to be entered into</b>’ (bold words added), given that the certification is intended to be provided prior to entering into (or renewal, see later comments) of a contract.</p> <p><i>Frequency/timing of certifications</i></p> <p>Para 25 appears to specify timing for para 24 certifications to be provided to APRA, but also appears to indirectly introduce requirements for certifications in addition to those required by para 24 i.e. on renewal (which is undefined) and, in certain circumstances, biennially.</p> <p><b>Recommendation 3</b> For clarity, the circumstances in which certification is required, other than before entering into a contract, should be specified directly in SPS 250 rather than indirectly as in draft para 24.</p> <p>In addition, we query whether requiring certification (prior to) an <i>insurance arrangement</i> being ‘entered into’ will achieve the desired outcome:</p>
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	<ol style="list-style-type: none"> <li>(1) For insurance through a life insurer, an <i>insurance arrangement</i> is defined in draft SPS 250 para 17 as an insurance policy document (contract)</li> <li>(2) It is common for such contracts to be written as ongoing contracts without any specific term but with a limited premium guarantee period after which the insurer has the right to change the premium rates. Historically a 3 year guarantee period was usual but in recent years shorter guarantee periods have become more common.</li> <li>(3) In such ongoing contracts, if any changes to premium rates and/or other terms and conditions are agreed then the contract is typically amended by a policy annexure rather than a new contract being entered into – would this be regarded as a ‘renewal’ under para 25? What if the contract provided a 1-year rate guarantee but the insurer did not exercise its right to amend the rates after one year - would this be regarded as a ‘renewal’ requiring certification? What level of change to a policy would be required to constitute a ‘renewal’ for the purpose of certification? Or does ‘renewal’ only refer to a policy being renewed after it reaches the end of its term?</li> <li>(4) If ‘renewal’ does only refer to a policy being renewed after it reaches the end of its term it appears to us that for the commonly held ongoing policies referred to above, draft para 25 would require a biennial certification.</li> <li>(5) Despite shorter premium rate guarantee periods in some instances, it is still common for trustees to adopt a three yearly review cycle where possible due to the desirability of providing stable insurance arrangements to members, the complexity of the contracts (including reviewing and enhancing cover levels and design to best suit different member cohorts), and the need to modify the fund’s administration systems and processes and member disclosure material to cater for any changes. Given this, a biennial certification period may result in a certification being required out-of-cycle with the trustee’s insurance review process.</li> </ol>
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	<p>(6) In practice this may lead to 2 certifications being required in a 3-year period (i.e. the biennial at 2 years and another at 3 years) as a trustee may not want to agree contract changes without having a certification in place.</p> <p>(7) Given the costs involved, we do not believe funds should be required to obtain certifications more than once in a 3-year period and that trustees should have the flexibility to determine the timing of certifications in the most efficient manner - in particular at the time of changes to pricing, design or terms and conditions where this occurs within a 3-year period.</p> <p>(8) A 3-year period would also facilitate alignment with the existing requirement in para 27 for an independent review of a Trustee's Insurance Management Framework on a 3-year basis, and there may be cost efficiencies if these reviews can be completed in tandem.</p> <p><b>Recommendation 4</b> <i>We recommend certification be required of a contract before it is entered into and at least each 3 years. If certification is also to be required before 'renewal' then 'renewal' should be clearly defined.</i></p>
<p>A.2 Required certification that the arrangement is in the best interests of the beneficiaries</p>	<p>Aspects of group life insurance arrangements are subjective and experts will have different opinions about what the most appropriate terms are. In our view this makes it problematic for any expert to certify that any particular arrangement is in the best interests of the beneficiaries as they will invariably have different views about what the best combination of cover design and terms and conditions would be, even allowing for the desirability of stable arrangements. Imagine a future Royal Commissioner asking the expert to explain how they were able to certify that terms and conditions B, Q and Z for cohort 25 were in the best interests of members. Is there also a risk that the certification would, in effect, outsource the trustee's assessment of best interests?</p>



	<p>We understand the Hayne Royal Commission's concerns were that related party arrangements may not represent fair value to members compared with what could be obtained through an arm's length arrangement.</p> <p><b>Recommendation 5</b></p> <p>Given the problems with a 'members' best interests' certification, we recommend that the certification be re-framed to be directed at assessing whether the arrangement is reasonably considered to be market-competitive (or on arm's length terms) and, in the certifier's opinion, reasonable for a Trustee to consider in beneficiaries' best interests.</p> <p>We suggest adding the following provision could be one way of achieving this more targeted outcome:</p> <p><i>In order to certify that the arrangement is in the best interests of the beneficiaries, the person providing the certification must be satisfied that, on balance:</i></p> <ul style="list-style-type: none"> <li><i>(i) the terms and conditions (including the pricing and service levels) of the arrangement are not materially inferior to the terms and conditions that the person would reasonably expect to be achieved from a competitive tender; or</i></li> <li><i>(ii) if (i) does not apply, the arrangement may still be capable of being considered by the Trustee as in the best interests of the beneficiaries.</i></li> </ul> <p>Point (ii) is included to cater for situations such as:</p> <ul style="list-style-type: none"> <li>• where the cost of changing insurer outweighs the likely value of improvements in terms and conditions</li> <li>• PYS/PMIF type circumstances where the (i) certification may be difficult yet arrangements need to remain in place to cover the period until a competitive assessment or other review can be undertaken.</li> </ul>
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	<p>A type (ii) certification could potentially also be used to certify a shorter contract during which the trustee is required to address the concerns that prevented certification of a longer contract on the terms and conditions proposed by the trustee and the insurer.</p> <p>Another workable alternative may be:</p> <p><i>In order to certify that the arrangement is in the best interests of the beneficiaries, the person providing the certification must be satisfied that, on balance, the terms and conditions (including the pricing and service levels) of the arrangement are not materially inferior to the terms and conditions that the person would reasonably expect to be achieved from an arm's length negotiation between the parties.</i></p>
A.3 Required certification that the arrangement otherwise satisfies all applicable legal and regulatory requirements	<p>This appears to require an extremely wide and unqualified certification which is far more onerous than the terms of the assurance required from the fund's auditor. We consider this is unreasonable given both the scope (i.e. 'all applicable legal and regulatory requirements') and the greyiness of many of the applicable legal and regulatory requirements and the fact that views about what some of these require are constantly changing. Consider the following examples:</p> <ul style="list-style-type: none"> <li>(i) Does the scope of the certification include that the expert is satisfied that the insurance arrangements do not inappropriately erode the balance of any member? There is huge scope for legitimate differences of opinion here.</li> <li>(ii) Does the scope of the certification include that claims assessment processes meet all applicable legal and regulatory requirements?</li> <li>(iii) Does the expert need to check that the contract meets the requirements of the Life Insurance Act? And Commonwealth and State/Territory human rights and equal opportunity legislation?</li> <li>(iv) Having regard to the views about 'activities of daily living' (ADL) TPD cover expressed by ASIC in REP 633, could either limb of the draft certification be provided for arrangements that include ADL TPD cover?</li> </ul>

	<p>The wider the scope of the certification and the more grey areas it is required to cover, the more costly the certification will be. Why would such a wide certification – extending well beyond related party type issues - be considered necessary for funds in these circumstances when it is not considered necessary for funds not in these circumstances?</p> <p>Furthermore, in our view the nature of this second limb of the certification implies the certifier would need to have legal qualifications, whereas we suggest that the first limb will require actuarial expertise. So what sort of professional does APRA envisage providing the required certifications?</p> <p>In our view the scope should be focused only on those areas where there are concerns that concessions may be inappropriately afforded to a related party insurer. We think the important areas are the pricing and other material terms and conditions, which require actuarial expertise to assess. .</p> <p>As the ‘best interest’ certification will cover these areas, in our view the second limb of the certification (satisfies all applicable legal and regulatory requirements) is not necessary to achieve the objective of the changes and raises doubts as to whether an actuary could provide the required certification.</p> <p><b>Recommendation 6</b> We therefore recommend the “satisfies all applicable legal and regulatory requirements” part of the certification be removed.</p> <p><b>Recommendation 7</b> If Recommendation 6 is not accepted, we recommend that, to reduce the cost and appropriately target the certification, the final SPS 250 specifies the particular legal and regulatory requirements that the certification is required to cover.</p>
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A.4 Negative certification	<p>Draft paragraph 18(n) refers to a negative certification whereas paragraphs 24 and 25 do not appear to cater for this. We suggest a negative certification does not make sense, rather the trustee may be unable to obtain the required certification.</p> <p><b>Recommendation 8</b></p> <p>We recommend the draft be modified to require that, where a person has been commissioned to provide the certification but has been unable to do so, a report prepared by that person setting out the reasons why must be provided to APRA in the same timing as the certification would be required to be provided under paragraph 25.</p>
A.5 Meaning of ‘the insurer is given a priority or privilege’	<p>In our view this provision will be problematic to comply with as in almost any situation there will be elements of the arrangement that could be considered to give a priority to the insurer. For example, every incumbent is given a priority because it is costly and disruptive to change insurers. We presume this is not intended to be caught as then every contract renewal would be caught.</p> <p><b>Recommendation 9</b></p> <p>We recommend clarifying this requirement by modifying to ‘the insurer is given a priority or privilege <b>that would be considered to be out of line with arm’s length market practice</b>’ and that, to guide industry participants, the updated SPG 250 should provide some non-exhaustive examples of what “priorities or privileges” would come within the provision.</p> <p><i>Specific exclusion for successor fund transfers (SFTs)</i></p> <p>Mercer operates a corporate superannuation master trust, the Mercer Super Trust (MST), which has around 230 participating employers, around 240,000 members and more than \$24 billion in assets under management. The MST has a number of group insurers, none of which are related party insurers. A number of these insurers only cover one employer plan in the MST, with the arrangements carried over as a result of a successor fund transfer (SFT) where the trustees agreed that this was appropriate meet the ‘equivalence’ requirements for an SFT. Clearly these were arms’ length decisions</p>



	<p>made in the best interests of members rather than to benefit the incumbent insurer. We submit that it would be inappropriate to add to SFT costs by requiring independent certification in such cases. We note that in many such cases there are not large numbers of members involved.</p> <p><b>Recommendation 10</b> We recommend that either SPS 250 or the related SPG make it clear that entering into a contract with the predecessor fund insurer in connection with an SFT to secure equivalency of insurance rights in respect of transferring member benefits would not be regarded as a situation requiring certification.</p>
A.6 What is an 'independent certification'?	<p>Draft para 24 refers to an 'independent certification'. This differs from the para 27 requirement for the insurance management framework (IMF) to be reviewed by 'operationally independent, appropriately trained and competent persons at least every three years'.</p> <p>Clarity is needed on the definition of independence for the purposes of the new certification and there would be benefits if it aligned with the existing requirement in para 27, allowing the same party to complete both the IMF review and the certification.</p> <p><b>Recommendation 11</b> We recommend that the 'independent certification' wording of draft para 24 be amended to at least align with the para 27 wording of 'operationally independent, appropriately trained and competent persons'.</p>