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Mr [redacted]
General Manager, Policy Development
Australian Prudential Regulation Authority
GPO Box 9836
SYDNEY NSW 2001

By email: [redacted]

Dear Mr [redacted]

RESPONSE TO CONSULTATION: PROPOSED REVISIONS TO PRUDENTIAL STANDARD SPS 250 AND PRUDENTIAL GUIDANCE SPG 250 INSURANCE IN SUPERANNUATION

Thank you for the opportunity to provide a response to this consultation. We are supportive of lifting standards in relation to insurance in super, and we are of the view that the changes to the standards will improve insurance arrangements for beneficiaries. However, we feel that the guidance for RSE licensees in SPG 250 could benefit from greater clarity in order to reduce the risk of unintended consequences.

Our response focuses on four key areas:

- The scope of contractual terms that are deemed “priority or privilege” and how this may lead to insurance arrangements that are less favourable to beneficiaries than may otherwise have been the case
- Practical issues with the independent certification and how RSE licensees resolve any differences with persons undertaking the independent certification
- Guidance where the purpose is unclear and may lead to unintended or misleading outcomes
- Operational risk issues with the proposed opt-out guidance

1. Contractual terms that are considered to grant priority or privilege to insurers

Paragraphs 52 to 58 of the updated SPG 250 set out guidance for RSE licensees to seek independent certification where arrangements provide a priority or privilege to an insurer (in addition to where there is a related party insurer).

There are certain contractual terms that would give rights to insurers, but not provide any compensating benefits to the RSE licensee or beneficiaries. An example of this is in paragraph 57(a)(iii), where an incumbent insurer is given priority in a tender process. This clearly leads to probity issues and it is questionable whether RSE licensees would benefit from this.

Other contractual terms that give ”priority or privilege” rights to an insurer would typically be negotiated with an RSE licensee on a quid pro quo basis, with compensating benefits provided by an insurer to beneficiaries. Paragraph 56 states that the person making the assessment for the independent certification can prudently consider whether there are any compensating benefits that offset the adverse impacts of these ”priority or privilege” contract terms.

We are of the view that the requirement to obtain an independent certification, with the associated cost, inconvenience and resourcing this would require, is likely to see RSE licensees eschewing priority or privilege contractual terms altogether, and the compensating benefits typically offered. This may result in insurance arrangements being less favorable to beneficiaries than may otherwise have been the case.

We propose that the standard is amended to reflect that RSE licensees should be empowered to use their judgement in determining whether the compensating benefits provided are an appropriate offset for the inclusion of the "priority or privilege" right, and could be required to demonstrate this judgement to APRA.

An independent certification should not be a mandatory requirement but a reasonable option for a trustee to undertake.

Trustees are already bound by Insurance Covenants in Section 52(7) of SIS and will soon have additional obligations to act in the best financial interest of beneficiaries with the proposed Your Future, Your Super package.

Paragraph 56 reflects that compensating benefits may offset the otherwise adverse "priority or privilege" terms, with examples noted such as price reductions or improvements to other terms and conditions of the arrangement. It is not clear whether the examples given are intended to be an exhaustive list that someone undertaking an independent certification should take into account.

We believe there are other matters that may not be expressly negotiated between RSE licensees and insurers but are nonetheless important to consider when forming a reasonable view about whether they offset the adverse "priority or privilege" terms. This includes the stamp duty costs when entering into a new insurance contract (which are added to risk premiums and ultimately incurred by beneficiaries) or the transition costs (both real and opportunity) of entering into an arrangement with a new insurer.

If these factors aren't taken into account, the assessment has not considered all of the factors that the RSE licensee would be expected to consider when determining the insurance arrangements it will enter into and the holistic impact to beneficiaries.

We propose that the guidance is expanded to reflect that compensating benefits can be broader than those specifically listed. We further propose that the guidance include stamp duty costs when entering into a new insurance contract, and the transition costs (both real and opportunity) of entering into an arrangement with a new insurer, as matters that it is prudent for someone undertaking an independent certification to consider when forming their view.

2. Practical issues with the independent certification

Clause 24(a)(ii) of SPS 250 notes that the material alteration of an insurance arrangement is a trigger requiring an independent certification be performed prior to entering into insurance arrangements.

However, the updated SPG 250 does not provide any guidance on what constitutes a material alteration of insurance arrangements.

There is also the risk that trigger events many occur in a relative short period after the last certification was undertaken. For example, a legislative change could require a material alteration to insurance terms, as the *Protecting Your Super* reforms did. If these changes were to occur shortly after a renewal, it would not be practical nor cost effective to have to gain another independent certification so soon after the last, and the benefits to beneficiaries would be questionable.

SPG 250 should provide guidance on what would constitute the material alteration of an insurance arrangement.

The guidance should also make it clear that altering the terms of an existing arrangement in response to legislative change should not be considered a trigger in isolation, provided the alteration to the arrangements are solely in response to the legislative change.

Clauses 25(a) and 26 in the updated SPS 250 require an independent certification that *'…it is reasonable for the RSE licensee to form the view that the insurance arrangement is in the best interests of beneficiaries.'*

The updated SPG 250 does not contemplate how circumstances where the person performing the independent certification has a different view to the RSE licensee and how any differences should be

resolved. There is a need for guidance on how these circumstances can be resolved, otherwise it may lead to more drawn out processes and the risk of potential rounds of tendering.

To address circumstances where there is a difference of opinion between the person performing the independent certification and the RSE licensee, SPG 250 should provide guidance on a 'circuit breaker' mechanism to resolve these differences.

The updated SPS 250 uses the term "connected entity" in various sections and is further qualified by footnote 4. In paragraph 45(a) and (b) of SPG 250, references to connected entity are qualified in the context of being a related party insurer. It is unclear whether all references to "connected entity" refer only to related party insurers or if this differs in various sections.

If references to "connected entity" in SPS 250 and SPG 250 are intended to apply to related party insurers only, consistent language and qualification should be used between the two documents.

3. Guidance where the purpose is unclear and may lead to unintended or misleading outcomes

There are several areas of the updated SPG 250 where the need or rationale isn't clear. This may lead to unintended or misleading outcomes.

Observation	How this could be addressed
Paragraph 24 proposes that claim payment ratios should be maintained on both a cash and accrual basis where possible. It is questionable what benefit a loss ratio based on a cash basis provides to a RSE licensee, given the significant delays between the payment of premiums and the realisation of claims. In the case of disability products, assumptions about claims that have been incurred but not yet reported (IBNR) and the reserves held by insurers to meet expected continuing payments of IP claims (DLR) make up the significant majority of expected claims in the early years. In the absence of appropriate qualification, it is likely to be misleading and may lead to decisions based on inaccurate information.	We propose that references to claim payment ratios on a cash basis are removed from the guidance.
Paragraph 39(c) requires the RSE licensees to consider a number of factors when selecting an insurer, including the stability of premiums. We feel this is problematic for a number of reasons: • The incumbent insurer is the only insurer who can demonstrate the stability or otherwise of insurance premiums for that particular scheme. It's unclear how RSE licensees can assess the stability of premiums of a non-incumbent insurer. • Comparing stability of premiums on a general basis, for example across an insurer's whole group insurance pool, doesn't allow for factors that are inherent in the RSE licensee's own claims experience to be fairly assessed. • Stability can often be obtained by reducing benefits or eroding the richness of policy terms, which can mask underlying issues. • Stability of premiums for a particular plan may have been driven by a large number of factors, some inherent to that plan, where those same factors would have similarly impacted other insurers but could never be tested.	We propose that reference to stability of premiums is removed from the guidance. Otherwise practical guidance is required on how this might be achieved, given the challenges noted.
Paragraph 51 states that the entity performing the assessment for an independent certification must holistically assess, on balance, the reasonably expected impact on beneficiaries of the related party arrangements relative to arrangements available from non-related parties. It is unclear how the entity performing the assessment could do this without performing a tender, or a 'tender-like' activity. This could lead to an expectation that RSE licensees undertake a market tender as part of the renewal of any arrangements with related party insurers.	We propose that the guidance make clear whether an RSE licensee is required to undertake a market tender as part of the renewal of any arrangements with related party insurers. In the alternative, the guidance should clarify how an assessment of related party arrangements should be achieved.

Observation	How this could be addressed
Paragraph 57 sets out its expectations in relation to circumstances where an insurer (or reinsurer) ranks ahead of other insurers (a priority term). It isn't clear that the reference to reinsurer refers to insurance arrangements entered into between the RSE licensee and the reinsurers as distinct to a treaty entered into between an insurer and a reinsurer. Treaties may include commercial terms that insurers and reinsurers are not prepared to share with RSE licensees; for example, arrangements negotiated at a global or regional level.	We recommend that the guidance clearly states that Paragraph 57 relates to arrangements entered into between a RSE licensee and an insurer (or a RSE licensee and a reinsurer) to avoid any confusion that the treaty between insurers and reinsurers should be considered part of the insurance arrangements.
Paragraph 62 sets out rules for the attribution of status to a beneficiary e.g. defaulting members to a heavy blue-collar rating. These paragraphs don't make it clear that attribution refers to the defaulting of status by the RSE licensee.	Guidance should provide clarity that this is intended to apply to attributes that the RSE licensee selects for the member rather than where individual members make a choice; for example, nominating themselves as 'white collar', or a status that is not disputed, like age.

4. Operational risk issues with the proposed opt-out guidance

Paragraph 13 in the guidance requires RSE licensees to have a process in place to enable beneficiaries to opt out of insurance cover and for this to be communicated to beneficiaries. The guidance also proposes that RSE licensees are consistent, such that communication by email should allow a member to change or cancel insurance by email.

The use of email to cancel insurance cover creates a risk that the request is made by someone other than the beneficiary. It is prudent for RSE licensees to only act on instruction where they can be satisfied of the identity of the person making the request. This is more important in relation to insurance, given the material financial consequences of acting on a request made by someone other than the beneficiary.

Guidance should make it clear that while various channels should be promoted to reduce barriers to action, this shouldn't override the need to ensure that the identity of those making the request is verified.

Should you wish to discuss any aspects of our response, please contact [redacted]

Yours sincerely

[redacted]

[redacted]
AIA Australia and New Zealand