FSC FINANCIAL SERVICES COUNCIL

SPS 250 Insurance in Superannuation

FSC Submission

March 2021

Contents

1. About the Financial Services Council

The FSC is a leading peak body which sets mandatory Standards and develops policy for more than 100 member companies in one of Australia's largest industry sectors, financial services.

Our Full Members represent Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advice licensees and licensed trustee companies. Our Supporting Members represent the professional services firms such as ICT, consulting, accounting, legal, recruitment, actuarial and research houses.

The financial services industry is responsible for investing $3 trillion on behalf of more than 15.6 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange, and is the fourth largest pool of managed funds in the world.

2. Executive Summary

The FSC welcomes the opportunity to provide comment on the updated draft SPS 250 and SPG 250.

This submission focuses on areas where further refinement and guidance would be helpful to both RSE licensees and insurers in implementing the new Standard.

In particular, FSC members have a range of outstanding concerns in relation to the new independent certification process. It is also not clear how many of the requirements in the SPS and SPG are intended to apply to individual policies, rather than group arrangements.

We also note several areas where additional guidance is needed to clarify APRA's intent in relation to specific provisions and requirements.

The FSC also welcomes the revised commencement date for the Standard, which will allow sufficient time for trustees and insurers to embed the new requirements.

The FSC and our members would welcome the opportunity to further discuss any of the issues below.

3. FSC Recommendations

1. Amend the requirements for independent certification to require a negative assurance in relation to the best interests of members.
2. Provide clear guidance for trustees on the necessary steps to demonstrate that an insurance arrangement is in the best interests of beneficiaries.
3. Provide an explicit allowance for an independent certification to be provided after a new arrangement is in force, where it cannot practicably be obtained beforehand.
4. Provide additional guidance in relation to circumstances where an independent certification shows an insurance arrangement is not in the best interests of beneficiaries.
5. Clarify that the termination provisions are not relevant to individual policies, including those acquired via superannuation platform products.
6. Explicitly exempt individual insurance policies within superannuation from inappropriate requirements, and provide additional guidance in relation to application to individual policies where the Standard and Guidance do apply.
7. Provide additional guidance in relation to materiality of alterations to insurance arrangements, including clarifying that alterations due to legislative change do not create an automatic trigger to undertake a new certification in isolation, provided the alteration to arrangements are solely in response to the legislative change.
8. Clarify expectations in relation to renewals of related party insurance arrangements.
9. Expand guidance to reflect that compensating benefits considered under paragraph 56 can be broader than those specifically listed.
10. Clarify the definition of ‘priority terms’ for the purpose of paragraph 57.
11. Clarify that SPS250 relates only to arrangements entered into by trustees, and does not consider any arrangements which may be made between an insurer and reinsurer.
12. Allow additional flexibility in opt-out processes, including making guidance technology neutral where possible.
13. Provide additional guidance in relation to compliance with the Insurance Contracts Act 1984 in different scenarios.
14. Clarify minimum and/or ‘best practice’ data retention timeframes beyond the expiry of risk, including transition timeframes as appropriate.
15. Remove references to claims ratios being calculated on a cash basis from SPG 250.
16. Provide additional guidance in relation to assessing needs of members and their likelihood of making a claim.

17. Remove reference to stability of premiums, or provide practical guidance to support trustees assessing and comparing premium stability.

18. Clarify the types of connected entities relevant in SPS 250.

19. Clarify that Paragraph 62 applies to attributes selected by the trustee on behalf of the member.

4. Comments on draft documents

4.1. Comments on SPS 250

Independent Certification

Best interests

In the FSC's previous submission, we noted concerns with the requirement that trustees obtain independent certification that certain arrangements are in the best interests of the beneficiaries.

While we note that the wording of relevant Paragraphs has been amended to require a certification that "it is reasonable for the RSE licensee to form the view that the insurance arrangement is in the best interests of the beneficiaries" it is still not clear that an external third party will be able to provide this level of assurance to a client.

The FSC considers, as recommended previously, that it would be more appropriate to require a negative assurance – ie assurance that the insurance arrangement "is not inconsistent with the best interests of the beneficiaries."

It should then be the role of the trustee to satisfy itself that the arrangements are in the best interests of members, and provide appropriate documentation to APRA to support this view.

We also suggest, however the requirement is drafted, that APRA clearly articulate in the final prudential standard (or guidance) the necessary steps that trustees will need to take to form a view (and demonstrate to an independent certifier) that an insurance arrangement is in the best interests of the beneficiaries. This may include any considerations for selecting independent certifier, including any conflicts of interest which may occur in relation to the use of consultants for both certification and tendering processes.

We also note that independent certification is likely to be a costly exercise, both financially and in terms of time commitment for trustees, and could become a significant factor in compliance costs. This cost will increase depending on factors including how often certifications are required and the complexity of the certification process.

Recommendation

1. Amend the requirements for independent certification to require a negative assurance in relation to the best interests of members.
2. Provide clear guidance for trustees on the necessary steps to demonstrate that an insurance arrangement is in the best interests of beneficiaries.

Timing of independent certification

There may be instances where an independent certification may not be able to be obtained before entering into a new arrangement. This could apply in cases where a trustee is required to appoint a new insurer due to the termination of an existing insurance

arrangement by either party. For example, this may be due to the insurer exiting the market, or the trustee terminating an arrangement as it does not meet the certification requirements.

In these instances, a trustee may need to appoint a new insurer, and enter into a new arrangement, within a very short period of time to ensure continuity of cover for members.

We recommend some allowance be considered so that an independent certification is not required prior to the new arrangement entering into force, but permit this to be provided within a set number of days following (say 90 days). This will allow enough time for the certification to be sought and obtained.

Recommendation

3. Provide an explicit allowance for an independent certification to be provided after a new arrangement is in force, where it cannot practicably be obtained beforehand.

Inability to obtain an independent certification

Additional clarity is required in relation to the options available to a trustee where an insurance arrangement is not assessed as being in the best interests of a beneficiary.

Paragraph 18(n) notes that insurance arrangements should include the right for the RSE licensee to terminate the arrangements if the independent certification (IC) does not state it is reasonable for the licensee to form the view that the insurance arrangements are in the best interests of beneficiaries.

It's unclear whether a trustee can enter into, renew, materially alter or keep arrangements despite the independent certification not forming a view that the arrangement are in the best interests of beneficiaries, where the trustee disagrees with the independent certification.

It would be preferable if one of the outputs of the certification was to outline the steps required to meet the minimum standards and the timeframe within which these must be met, rather than requiring immediate termination of the arrangement. Given the time and cost required to replace a terminated insurance arrangement (this may take 6-12 months depending on complexity of the arrangement), an alternative process may result in better outcomes for fund members.

There is also no guidance on how any disagreements between trustees and the entity performing independent certification can be resolved.

It would be helpful to clarify the obligations of the trustee in this instance, and provide guidance on the appropriate approach to managing a dispute.

Recommendation

4. Provide additional guidance in relation to circumstances where an independent certification shows an insurance arrangement is not in the best interests of beneficiaries.

Individual policies

While it is reasonably clear how the termination provisions would work in practice for group policy arrangements, it is difficult to see how it would work for individual policies.

A common scenario is where a customer is advised by their financial adviser to take out an individual retail policy via a superannuation platform product. If the trustee exercised the right to terminate an individual insurance policy arrangement, it is not clear where this would leave the customer. For example:

- Would the customer's individual policy be required to be cancelled by the trustee, leaving the customer without insurance?
- If the policy remains in force, how would ownership be structured? Would the insurer still be obliged to administer the insurance policy immediately after an arrangement is terminated, as if the arrangement was still in place?
- How should the trustee respond when it is determined an independent certification cannot be obtained? Would the trustee and the insurer be provided a [time limited] opportunity to work with each other to address gaps/failings if an independent certification cannot be obtained?

Recommendation

5. Clarify that the termination provisions are not relevant to individual policies, including those acquired via superannuation platform products.

Individual insurance arrangements

The SPS and SPG appear to have been largely drafted with a view to their application to group insurance arrangements. Several sections of the Standard and Guidance appear inappropriate for individual insurance policies inside superannuation. For example:

- the termination provisions noted above, which will result in unintended outcomes if implemented for individual policies;
- requirements for opting out of cover may not be appropriate for individual advised policies, and alternative approaches such as prompting conversations between the adviser and client may be more suitable;
- some of the requirements relating to inclusions in the Policy Document are not relevant to individual policies, and would significantly increase the volume (and cost) of information provided to these customers, including:
    - *(d) availability of opt in and/or opt out cover;*
    - *(f) premium structure, including any variable components;*
    - *(g) procedures for notification and payment of claims;*
    - *(i) agreed service standards;*
    - *(j) reporting requirements for monitoring agreed service standards;*
    - *(k) the provision of complete claims information to the RSE licensee on an annual basis which, at a minimum, includes the information required to be maintained by the RSE licensee under paragraph 1514;*
    - *(l) liability and indemnity arrangements;*

Given the nature of individual policies, it would be appropriate to exempt them from compliance with the relevant sections of the SPS and SPG. This would improve outcomes for members who have these arrangements in place.

If this approach is not taken, additional guidance will be required to support the application of the Standard to individual policies.

Recommendation

6. Explicitly exempt individual insurance policies within superannuation from inappropriate requirements, and provide additional guidance in relation to application to individual policies where the Standard and Guidance do apply.

Altering insurance arrangements

Paragraph 24(a)(ii) introduces the concept of materiality in relation to altering the terms of insurance arrangements.

However, no guidance is provided on the types of changes that would be considered material.

It would be helpful for SPG250 to provide guidance on the types of circumstances where that materiality threshold is breached.

The guidance should also clarify that merely altering the terms of an existing arrangements in response to legislative change e.g. a PYS like event should not be considered a trigger in isolation. If these events are considered to trigger a new certification, there is a significant risk of the independent certification being required for periods covering very short durations (e.g. where a legislative change takes effect 6 months after the last renewal). This would be impractical and costly.

Recommendation

7. Provide additional guidance in relation to materiality of alterations to insurance arrangements, including clarifying that alterations due to legislative change do not create an automatic trigger to undertake a new certification in isolation, provided the alteration to arrangements are solely in response to the legislative change.

4.2. Comments on SPG 250

Independent certification

Comparing impact on beneficiaries

Paragraph 51 states that the entity performing the 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's unclear how the entity performing the certification could do this without a tender, or a 'tender like' activity having been performed.

This could lead to an expectation that the RSE licensees undertake a market tender as part of the renewal of any arrangements with related party insurers. If this is not the intention, APRA should provide further guidance in relation to the certification process where a tender has not occurred.

Recommendation

8. Clarify expectations in relation to renewals of related party insurance arrangements.

Compensating benefits

Paragraph 56 introduces the concept of 'compensating benefits' which may offset any adverse impacts from a contractual term creating priority or privilege.

The guidance uses certain examples of compensating benefits such as a price reduction or improvements in other terms and conditions, but there are others which could be included, such as:

- stamp duty costs when entering into a new insurance contract;
- the transition costs (both real and opportunity) of entering into an arrangement with a new insurer; and
- ongoing governance and compliance costs for monitoring the insurance services (including claims assessment and claims decisions) provided by both the 'old' and 'new' insurers.

While these compensating benefits are not expressly negotiated between trustees and insurers when entering into these arrangements, they are an important factor to consider when forming a reasonable view. They should be taken into account as part of the certification process to ensure all the factors that the RSE licensee would be expected to consider are included.

Recommendation

9. Expand guidance to reflect that compensating benefits considered under paragraph 56 can be broader than those specifically listed.

Automatic renewal or rollover

Paragraph 57 indicates that APRA considers that a priority would be seen to exist if there were 'rights for automatic renewal or rollover of the arrangement without agreement by the RSE licensee'.

If this standard is applied, the vast majority of Group contracts would be considered as contracts with 'priority terms'. This is a feature of many Group insurance arrangements, as generally at the end of the price guarantee period, the contract continues automatically unless the trustee terminates it. It puts the trustee in a position of power, as the trustee can terminate at any time without cause (by giving a short notice period eg 3 months), while the insurer has virtually no right to terminate, except if there is non-payment of premium.

The FSC understands the intent is to capture exceptional situations where the arrangement is analogous to a related party arrangement, rather than broadly capture the majority of arrangements in the market.

It would be better if this were to read "rights for automatic renewal or rollover of the arrangement without agreement by the RSE licensee, *unless the RSE licensee has a wide discretion under the contract to terminate at any time*"

Recommendation

10. Clarify the definition of 'priority terms' for the purpose of paragraph 57.

Application to reinsurers

Drafting of paragraph 57 also does not make it clear that the reference to reinsurer refers to insurance arrangements entered into between the trustee and the reinsurers, as distinct to a treaty entered into between an insurer and a reinsurer.

It should be made clear that the Standard concerns itself with arrangements entered into between a trustee and an insurer (or a reinsurer) to avoid any confusion.

This is important as there may be commercial terms in treaty that insurers and reinsurers are not prepared to share with trustees e.g. terms negotiated at a global or regional level.

Recommendation

11. Clarify that SPS250 relates only to arrangements entered into by trustees, and does not consider any arrangements which may be made between an insurer and reinsurer.

Opt-out process

While FSC members generally agree with the opt-out processes set out in paragraph 13, and the need for a simple opt-out process more broadly,

For example, a personalised link to a pre-populated form may not be an appropriate way to capture member preferences, as it does not provide sufficient flexibility for members with differing needs. It is not clear how funds could provide simple solutions in this manner for complex or multi-layered requests. While the intent of simplifying engagement is appropriate, this approach may lead to a proliferation of documents which only serve to confuse individuals.

A more flexible, technology-neutral approach would be more appropriate to allow funds to engage with their members in the simplest possible format.

It may also be difficult for trustees to provide some of the information proposed in paragraph 14 at a detailed level, for example how to access cover in future. This may change over time or differ between trustees and providing detailed information at a point in time risks misleading consumers. It would be better to provide more flexibility in how this kind of information is presented.

Recommendation

12. Allow additional flexibility in opt-out processes, including making guidance technology neutral where possible.

Good faith duty

Paragraph 11 of the SPG indicates that it is expected that an RSE licensee's insurance management framework would specifically consider compliance with the *Insurance Contracts Act 1984*.

If would be helpful for APRA to provide further detail about the regulator's expectations, including:

- practical examples in relation to issues that may stem from s.13 of ICA 1984 – such as the need to undertake procedural fairness (also known as 'show cause' and 'natural justice') as a precursor before declining a customer's claim / avoiding a customer's policy due to non-disclosure;
- scenarios which fall outside s.13 considerations i.e. situations were procedural fairness is not necessarily required (for example, a declining a claim because member doesn't have insurance cover);
- expectations about what is considered an appropriate time to give a customer to respond to such notices (noting 30 days or 1 calendar month is generally considered the industry standard).

Recommendation

13. Provide additional guidance in relation to compliance with the Insurance Contracts Act 1984 in different scenarios.

Data maintenance

Paragraph 17 expands the data record requirements for claim experience to include additional specifics for the dates of claim notification and claim payment. It is possible that these details may not be available in all circumstances, and it is recommended that flexibility be provided for retrospective application of these requirements, with the new record keeping requirements to apply from the effective date of SPS 250.

Paragraph 18 notes that "APRA considers it good practice for an RSE licensee to continue to maintain insurance data beyond the expiry of insurance risk, and until the last claim payment is made."

It would be helpful if APRA could clarify the length of time that would be considered reasonable to retain this data. A transition period may be required for trustees to achieve minimum data retention periods where these are longer than current minimum time periods.

Noting that APRA's latest draft SRS 251.0 reporting standard seeks data for the previous 10 years, it would be helpful to clarify that APRA considers that an RSE licensee should maintain data for this period of time.

Recommendation

14. Clarify minimum and/or 'best practice' data retention timeframes beyond the expiry of risk, including transition timeframes as appropriate.

Claims payment ratios

Paragraph 24 proposes maintaining claim payment ratios on both a cash and accrual basis. However, it is not clear what benefit a loss ratio calculated on a cash basis provides to a trustee, and it would be costly to build and maintain this record.

This data has significant practical limitations and is likely to be misleading to a trustee without appropriate qualification.

Recommendation

15. Remove references to claims ratios being calculated on a cash basis from SPG 250.

Expected needs of members

Paragraph 26 requires trustees to measure certain metrics against the expected needs of the relevant cohort of members, and consider the likelihood of members needing to claim.

It's unclear what is meant by 'needs' in this context. For example, this could be interpreted as:

- the level of cover required to meet the needs of these members; or
- the types of cover most relevant for the cohort (for example, younger members may be less likely to need death cover).

Similarly, it is unclear whether the 'likelihood to claim' assessment is targeted toward:

- ensuring that age based cross subsidies are removed or reduced; or
- determining whether the types and levels of cover provided are relevant for that cohort (for example, a cohort who is largely single with no debt so don't need death cover, or default IP benefit is set at a level above the average income for that cohort.)

Trustees generally hold limited information relating to the expected needs of members, which will make this analysis difficult to undertake. While the level and reliability of information held by trustees continues to improve, it is unlikely to be sufficient to fully assess members' needs today.

It should be clear that these assessments include consideration of factors such as claims made and the types of cover provided, but do not create a requirement for trustees to have considered the underlying health of members, which would make up a significant component of the likelihood to claim.

APRA should also clarify how these requirements are expected to apply to individual underwritten policies.

Recommendation

16. Provide additional guidance in relation to assessing needs of members and their likelihood of making a claim.

Insurer selection

Paragraph 39(c) creates a requirement for trustees to consider stability of premiums when selecting an insurer.

It is not clear how this would be done in practice. The incumbent insurer is the only one who has a track record that demonstrates the stability or otherwise of insurance premiums for that particular scheme.

It's unclear how trustees can assess the stability of premiums of a non-incumbent insurer. To do so on a general basis (e.g. stability of premiums across an insurers whole group insurance pool) doesn't allow for factors that are inherent in the funds own claims experience to be assessed.

Stability can also be obtained by reducing benefits or eroding policy terms to mask underlying issues. Comparing stability between insurers will rarely be able to produce an apples-with-apples comparison.

It is also inherently stacked against an incumbent where volatility of premiums for a particular plan may have been driven by a large number of factors, that would have similarly impacted other insurers had they insured the same plan (but could never be tested).

If APRA does not have a clear process in mind for undertaking an appropriate comparison of premium stability, then this reference should be removed.

Recommendation

17. Remove reference to stability of premiums, or provide practical guidance to support trustees assessing and comparing premium stability.

Connected entity definition

Paragraph 45(a) uses the phrase ‘a connected entity of the RSE licensee (a related party insurer) …’

However, SPS250 uses the term connected entity only. It is not clear whether a related party insurer is the only type of connected entity relevant to SPS250. If this is the case, specifically referring to a ‘related party insurer’ may be helpful to remove ambiguity.

Recommendation

18. Clarify the types of connected entities relevant in SPS 250.

Attribution of status

Paragraph 62 sets out rules for the attribution of status to a beneficiary e.g. defaulting members to a heavy blue-collar rating, but it is not clear that attribution refers to the defaulting of status by the trustee.

Guidance could clarify that this is intended to apply to attributes that the trustee selects for the member (ie default settings), rather than where individual members make a choice (for example, nominate themselves as ‘white collar’) or something which is not disputed like age.

Recommendation

19. Clarify that Paragraph 62 applies to attributes selected by the trustee on behalf of the member.