



Law Council
OF AUSTRALIA

Legal Practice Section

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Ms [REDACTED]
Acting General Manager, Policy Development
Australian Prudential Regulation Authority
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By email: [REDACTED]

Dear Ms [REDACTED]

PROPOSED REVISIONS TO PRUDENTIAL STANDARD SPS 250 INSURANCE IN SUPERANNUATION AND ACCOMPANYING GUIDANCE

1. The Superannuation Committee of the Legal Practice Section of the Law Council of Australia (**the Committee**)¹ welcomes the opportunity to make a submission to Australian Prudential Regulation Authority (**APRA**) in relation to the proposed updated revisions to *Prudential Standard SPS 250 Insurance in Superannuation (SPS 250)* and the proposed revisions to *Prudential Guidance SPG 250 Insurance in Superannuation (SPG 250)*.
2. APRA's revisions to SPS 250 are directed to addressing:
 - two specific recommendations (4.14 and 4.15) of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (**Royal Commission**); and
 - APRA's concerns regarding consideration of whether or not the cost of insurance is inappropriately eroding the retirement incomes of beneficiaries, and the ease by which beneficiaries can opt out of insurance arrangements.
3. APRA released a revised SPS 250 for consultation in November 2019 (**Nov19 consultation**), and has now updated those revisions (**Jan21 update**) and released specific guidance through proposed revisions to SPG 250.
4. The Committee notes APRA's response to the Nov19 consultation and recognises the feedback and recommendations implemented by APRA in the Jan21 update.
5. The Committee will make some further comments in respect of:
 - the insurance strategy revisions;
 - the insurance arrangement revisions (in particular, the scope of an insurance arrangement, and the inclusion of termination provisions where an independent certification cannot be provided);

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- the nature of the independent certification (including, the meaning of priority and privilege and the meaning of independent); and
- some transitional matters.

Insurance Strategy

6. The Committee notes that in responding to feedback from the Nov19 consultation, APRA has in respect of paragraph 16:
 - redrafted sub-paragraph (a) to focus on the “methodology” used to assess whether or not the cost of insurance inappropriately erodes the retirement income of beneficiaries; and
 - included a new sub-paragraph (b) to require an RSE licensee to document how its assessment under section 52(11)(d) of the SIS Act will be documented in the RSE licensee’s annual member outcomes assessment.
7. The Committee queries the purpose of, and need for, paragraph 16(b). It requires the Register of Superannuation Institutions (**RSE**) licensee to “document” how it will “document” the required assessment. It is unclear how this sub-paragraph would add anything helpful to the insurance strategy requirements. If the purpose is to include a requirement to document the actual assessment, in the Committee’s view that has been covered appropriately by SPS 515 Strategic Planning and Member Outcomes and the accompanying guidance. On this basis the Committee recommends removing sub-paragraph 16(b) and including a footnote with a cross-reference to the appropriate paragraphs in SPS 515 and SPG 516.

Insurance Arrangements

Meaning of Insurance Arrangements

8. Paragraph 17 has been amended to expand the scope of the term “insurance arrangement” to include “any agreements” (rather than any “accompanying” agreements) relating to making available insured benefits.
9. It is unclear to the Committee what other agreements are intended to be caught by this paragraph, particularly where the agreement in question is not with the insurer but with “any other party”.
10. With the introduction of the independent certification requirement, it will be even more important than before for all interested parties to have a clear understanding of what, beyond the insurance policy document itself, forms part of the insurance arrangement.
11. The Committee recommends that further guidance be provided as to the type of arrangements intended to be caught. Additionally the Committee respectfully suggests that the following formulation may be preferable:

...and any agreement (in addition to any insurance policy document) between the RSE licensee and any other party (whether or not an insurer), if, and to the extent that, the agreement concerns making available insured benefits.
12. A key advantage of this formulation would be that if an agreement between the RSE licensee and a party other than the insurer deals with making available insured

benefits, and also deals with other matters, and if the overall insurance arrangement must terminate (because the independent assessment is adverse), then it would be clearer, on the face of the standard, that only the component of the agreement between the RSE licensee and the other party (who in this case is not the insurer) concerning making insured benefits available must terminate, and so the other component of the agreement (unrelated to insurance) may continue.

13. Clarity around the scope of the insurance arrangement is also important as another flow on effect is that the “other arrangements” may be caught by the outsourcing requirements in SPS 231 Outsourcing (as referenced in footnote 12). Guidance would also be appreciated in respect of the interaction and overlap between SPS 250 and SIS 231.
14. As a technical issue, should the wording in paragraph 17 remain as updated, the Committee recommends amending footnote 12 to mirror the changes in paragraph 17 to remove the word “accompanying”.

Administration Agreements

15. Paragraph 47 of the proposed revised version of SPG 250 states that “administration agreements” may fall within the 'broad definition of insurance arrangement' and, if so, they “would be considered as part of the independent certification process”.
16. The Committee understands APRA is of the view that a standard superannuation fund administration agreement, where the fund administrator provides standard services (including services concerning insurance) would not be caught, but that an administration agreement (or a separate agreement between the trustee and the administrator) would be caught if it included insurance-related services and duties for the administrator above and beyond what might be considered "standard".
17. The Committee recommends that this guidance be reflected in the SPG in order to provide some further clarity around this issue.

Matters that an Insurance Arrangement Must Address - Termination

18. In relation to the matters that an insurance arrangement must address, APRA has revised new paragraph 18(n) (originally inserted in the Nov2020 update) requiring the inclusion of a right of termination in the insurance arrangement (in favour of the RSE licensee) in the event that the independent certification (required by paragraphs 25 or 26) does not state that it is reasonable for the RSE licensee to form the view that the insurance arrangement is in the best interests of the beneficiaries.
19. The Committee makes three comments in respect of paragraph 18(n).
20. *First*, in the Committee’s view the objective of paragraph 18(n) cannot on the basis of the current drafting be achieved. The requirements in paragraphs 25 or 26 are that an RSE licensee obtain an independent certification (in the prescribed circumstances) that states that it is reasonable to conclude that the insurance arrangement is in the best interests of the beneficiaries. If the certifier cannot provide that certification, the certification simply will not be given, and the trustee will not be able to proceed with the arrangement. It is highly unlikely, in the Committee’s view, that a certification will state that is “not reasonable” for the trustee to form the relevant view. Rather the certification will not be given. If this is the case, then the right of termination provided for in paragraph 18(n) would never be activated. A better approach would be to

encapsulate a broader termination right linked to the best interests of the beneficiaries, so that the termination right is available where the RSE licensee is unable to form the view that arrangement is in the best interests of beneficiaries.

21. Consistent with the Committee's earlier submission, the Committee also notes that, at present, few if any insurance arrangements will address a termination right in the event of a 'negative' independent certification. What is much more likely is that many arrangements would address that matter indirectly, by giving the trustee a termination right in the event that the arrangement was considered to be contrary to law or the trustee's duties.
22. In light of this context, the Committee recommends that it would be preferable to refine paragraph 18(n) by replacing the relevant text with:

... the termination provision must include a right of the RSE licensee to terminate the insurance arrangement, if the arrangement is not in the best interests of the beneficiaries.

23. The Committee anticipates that, in some cases, an insurance arrangement may need to be renegotiated in order to deal with the possibility of an adverse certification. The Committee suggests that APRA should consider amending its prudential standards for life companies to require them to allow a superannuation trustee to have appropriate termination rights, in turn to ensure that there are no barriers to trustees complying with APRA's proposed amendments to SPS 250.
24. As a *second* point, the Committee notes that the construction of paragraph 16(n), does not align with the sentence leading into the list (ie (a) – (n)). Currently it reads:

At a minimum, the insurance arrangement must address:

(n) *without limiting sub-paragraph 18(m) to specify a termination provision, the termination provision must include...*

25. Although sub-paragraph (n) could be reorganised to align with the sentence leading into it, the Committee recommends that a better approach would be to make paragraph 18(n) a standalone paragraph (as a new paragraph 19). This seems to be the premise on which the paragraph was initially drafted. Additionally the words "to specify a termination provision" are not required and should be deleted.
26. As a *third* point, the current paragraph 18(n) is intended to apply only to new insurance arrangements entered into on and from the effective date of the Prudential Standard. The Committee recommends that it would be more consistent for paragraph 18(n) to also apply in respect of renewals and material changes. While this anticipates potential negotiation between the RSE licensee and insurer, this approach has the advantage of connecting with the operation of the certification requirements applying in respect of renewals and material changes (because of the operation of paragraph 24(a)(ii)). It also ensures that trustees, and ultimately members, have the protection of a termination clause in the event an arrangement is not in the interests of beneficiaries.

Independent Certification

27. Paragraphs 25 – 26 generally require an RSE licensee to obtain an independent certification that it is reasonable for the RSE licensee to form the view that the relevant

insurance arrangement is in the best interests of the beneficiaries. This will apply in two circumstances, which in summary are:

- if the insurer is a connected entity of the RSE licensee (“related parties”); and
- if the insurer is not a connected entity, but where the insurance arrangement provides the insurer with a priority or privilege (“priority or privilege”).

28. The Committee notes that APRA has updated the proposed Nov2020 revisions to ensure that the decision regarding best interests remains with the RSE licensee. Having regard to the further revisions to these paragraphs, the Committee comments as follows.

Applicable Legal and Regulatory Requirements – Paragraph 25

29. Paragraph 25(b) generally requires that the independent certification in respect of related parties deal with the best interests of members and, in addition, with a further matter, as follows:

... the insurance arrangement otherwise satisfies applicable legal and regulatory requirements.

30. The Committee is of the view that it is inconsistent for paragraph 25 to require certification in respect of this further matter (in addition to addressing best interests), whereas paras 26, 31 and 32 are limited to addressing best interests. Additionally, compliance with law is inescapably a legal question, and can only be certified by a qualified legal practitioner. The proposed changes to SPG 250 indicates that APRA has in mind that independent certification should be able to be given by someone other than a lawyer. In any event, compliance with law is always required and an RSE licensee would in the ordinary course seek assurance of this outside of the independent certification process. To ensure consistency across paragraphs 25, 26, 31 and 32, and to ensure that the independent certification can be given by the range of certifiers that APRA intends, the Committee recommends that paragraph 25(b) be deleted.

Priority and Privilege

31. The Committee remains concerned that the circumstances in which an RSE licensee may or may not need to obtain independent certification (where the insurer is not a related party) will be uncertain.

32. In the Jan2021 revisions, the certification requirement for entities that are not connected entities has been separated into a new paragraph 26, but the language around requiring an independent certification in cases where the insurer is granted a “priority or privilege” has been maintained.

33. The SPG 250 has been updated to provide detailed guidance on an independent certification for priority or privilege (paragraphs 52 – 58). Having regard to this guidance, the Committee is concerned that the practical effect of the guidance is so broad that most if not all trustees would effectively be required to obtain an independent certification. Most insurance arrangements include some element that is arguably a priority or privilege. In many cases these (arguable) priorities and privileges are also to the advantage of the beneficiaries and trustees having regard to the arrangement as a whole. For example, an insurance arrangement between a

trustee and an unrelated insurer may be for a long term. The long-term nature of the arrangement may be perceived to involve a priority or privilege for the insurer. And yet the long-term nature of the arrangement may easily yield benefits for the trustee and its members, including in the form of lower premiums.

34. As stated in our original submission, the Committee acknowledges paragraph 26 is intended to reflect the Royal Commission recommendation in this context and we note that the Commissioner used the words ‘by which the insurer is given a priority or privilege’ in recommendation 4.14 and appreciates that APRA has adopted virtually identical language. However, in order to understand what the Commissioner was concerned with, it is necessary to go back to the discussion in the Final Report. That discussion focussed on related party insurers and “questions of conflict”, before continuing (emphasis added):

And because conflicts can arise not only from legal structure but also from contractual arrangements, the same obligation should apply to any RSE licensee that has a contract, arrangement or understanding with a life insurer by which the life insurer is afforded a priority or privilege in connection with the provision of group life insurance to the RSE licensee.

35. With the benefit of this context, the Committee suggests that the scope of subparagraph 24(d) should be refined by replacing the proposed text with:

... gives, to an insurer that is not a related party, priority or privilege such as to raise questions of conflict of the kind that would be raised if the insurer were in fact a related party.

36. This would mean that “priority or privilege” that did not rise to the relevant level would not trigger the requirement to obtain certification. Almost all insurance arrangements arguably involve “priorities” or “privileges” of one kind or another for the insurer and yet the Commissioner plainly did not intend that the certification requirement would be triggered in virtually all cases. Unless some boundaries on “priority or privilege” are included in the standard itself, the standard will go much further than what the Commissioner intended. This problem cannot be solved by guidance in the SPG, with the standard being binding and the SPG not providing any relief from the binding standard. The Committee is concerned that the independent certification requirement may become disconnected from its origins evident in the applicable case studies in the Royal Commission, therefore applying in circumstances where it was not intended to apply (nor with justification for its application). That would be a great pity as trustees and insurers would be put to expense and distraction in demonstrating an arrangement was an appropriate arrangement when there was no real call to do so in the first place. In this case the trustee covenants are the appropriate standard to test the arrangement against.
37. In any event, the guidance provided in paras 50 – 58 is very detailed and prescriptive. The Committee recommends that a better approach may be to anchor the guidance in high level principles and guiding examples that focus on the two main concepts of best interests, and negotiating on an arm’s length basis (thereby managing any potential conflict). If an insurance arrangement is on an arm’s length basis, then many of the issues raised in guidance in respect of priority and privilege either fall away or are “managed” in terms of conflicts of interest or duty.

Meaning of Independent

38. The draft SPS 250 sets out at paragraphs 68 and 69 APRA's expectations regarding the person engaged to provide an independent certification, noting particularly that the person needs to be independent of the RSE licensee and the insurer. In Committee's view, it would be helpful if guidance could be provided about who is sufficiently independent to provide the certification is required. This could be done by the introduction of some high level principles to guide the RSE licensee's assessment. It is important that the assessment is appropriately linked to independence in relation to insurance matters, otherwise there is a real danger that RSE licensees may have difficulty finding a person sufficiently independent (if a broad range of advisors / consultants have used generally by the RSE licensee).

Certification cannot be provided

39. Under the transitional provisions, paragraph 34 requires an RSE licensee that is unable to obtain an independent certification for the purpose of paragraphs 31 and 32 (the certification requirements that apply during the transitional period) to notify APRA within 5 business after it has become aware that it cannot obtain an independent certification.
40. The Committee notes an inconsistency in that a counterpart of this requirement is not included in the main part of the standard (dealing with situations other than transitional situations). The Committee recommends that the same obligation be included in the main part of the standard (in the event that an RSE licensee is unable to obtain an independent certification as required by paras 24-26).

SP 250 – Terminology

41. The Committee notes that the terminology in the draft SPG 250 oscillates between "prudent" and "sound" practice. The Committee recommends adopting one of the phases (rather than changing between both).

Contact

42. The Committee would welcome the opportunity to discuss its submission further and to provide additional information in respect of the comments made above. In the first instance, please contact the [REDACTED]

Yours sincerely

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Deputy Chief Executive Officer