



Draft Prudential Practice Guide

LPG 270 – Group Insurance Arrangements

December 2013


Disclaimer and copyright

This prudential practice guide is not legal advice and users are encouraged to obtain professional advice about the application of any legislation or prudential standard relevant to their particular circumstances and to exercise their own skill and care in relation to any material contained in this guide.

APRA disclaims any liability for any loss or damage arising out of any use of this prudential practice guide.

© Australian Prudential Regulation Authority (APRA)

This work is licensed under the Creative Commons Attribution 3.0 Australia Licence (CCBY 3.0).

 This licence allows you to copy, distribute and adapt this work, provided you attribute the work and do not suggest that APRA endorses you or your work. To view a full copy of the terms of this licence, visit www.creativecommons.org/licenses/by/3.0/au/.

About this guide

Prudential Practice Guides (PPGs) provide guidance on APRA's view of sound practice in particular areas. PPGs frequently discuss legal requirements from legislation, regulations or APRA's prudential standards, but do not themselves create enforceable requirements.

This PPG outlines prudent practices in relation to group insurance arrangements. The main area of focus is life insurance, total and permanent disability insurance and income protection insurance provided to a registrable superannuation entity (RSE) licensee, for offering to beneficiaries. The insurer for these arrangements is usually a life company but may, for specific types of insurance benefits, be a general insurer. Many of the practices are also relevant for group insurance contracts where the policy owner is not an RSE licensee.

This PPG also discusses the implications for insurers of *Prudential Standard SPS 250 Insurance in Superannuation* (SPS 250). SPS 250 sets out APRA's requirements for RSE licensees in relation to making insured benefits available to beneficiaries. APRA has also issued guidance for RSE licensees in *Prudential Practice Guide SPG 250 – Insurance in Superannuation*.

For the purposes of this guide, 'registrable superannuation entity' and 'RSE licensee' have the meaning given in the *Superannuation Industry (Supervision) Act 1993* (SIS Act) and 'insurers' refers collectively to life companies and general insurers.

Subject to meeting APRA's prudential requirements, insurers have the flexibility to manage their group insurance arrangements in a manner best suited to achieving their business objectives. Not all of the practices outlined in this PPG will be relevant for every insurer and some aspects may vary depending upon the size, complexity and risk profile of the insurer.

Introduction

1. This PPG provides broad guidance to insurers on prudent practices for group insurance arrangements with regards to the identification of risks, responding to tenders and data management. It also discusses the implications for insurers of SPS 250 which sets requirements for RSE licensees with respect to making insured benefits available to superannuation fund beneficiaries.

Responsibilities

2. Under the SIS Act, an RSE licensee is generally required to provide death benefits and permanent incapacity benefits to all MySuper beneficiaries on an opt-out basis. An RSE licensee can also make certain types of insured benefits, including income protection, available to choice members. Self-insurance by an RSE licensee is only permitted in limited circumstances.
3. An RSE licensee is ultimately responsible for the insured benefits that are made available to beneficiaries. However, insurers, administrators and other parties also have roles and responsibilities in relation to the provision of insured benefits. APRA expects the insurer to understand the roles and responsibilities of all parties involved in the insurance arrangements of an RSE licensee.

Risk management framework

4. *Prudential Standard CPS 220 Risk Management* requires an insurer to have a risk management framework that includes risk management policies, controls and procedures to identify, assess, monitor, report on and mitigate all material risks. Insurance contracts expose an insurer to a range of asset, insurance and operational risks. Many of these risks are common to both individual and group insurance contracts. However, there are risks specific to group insurance that, if material, should be specifically identified within the risk management framework and taken into account in pricing and the assessment of capital adequacy. These include, but are not limited to:
 - (a) inaccurate or incomplete claims data being provided to the insurer by an RSE licensee or other external party such as a previous insurer. This can increase the risk that the premium rates will be inadequate and/or the liabilities will be understated. APRA expects that externally-sourced claims data would be regularly updated in order to ensure that it includes all reported claims. Refer also to paragraphs 38 to 41;
 - (b) failure by the insurer to identify adverse trends affecting future claims experience or failure to give sufficient weight to the uncertainty inherent in such trends. Examples of issues that could result in adverse trends include changes to benefit designs (including increases to automatic acceptance limits), changes to the membership profile, increases in the level of awareness by beneficiaries of their entitlement to claim insured benefits, changing social attitudes to disability (e.g. in the area of mental health), greater involvement of lawyers in the claims process, increasing delays in the reporting of claims and differences in claims philosophies between previous and current insurers;

- (c) failure by the insurer to adequately allow for the cost of profit-sharing arrangements. Complex modelling of the potential outcomes may be necessary as the insurer typically bears 100 per cent of losses but retains only a portion of profits;
 - (d) inadequate internal processes for responding to tenders. The insurer may not have sufficient staff with appropriate experience and expertise to be able to complete a thorough analysis of the tender in the time available. This can lead to inadequate premium rates or inappropriate terms and conditions being offered;
 - (e) anti-selection against the insurer by new or potential members. Anti-selection can occur when new members with a higher than expected risk of claim take out insurance cover with limited or no underwriting. It can also occur if potential members with a lower than expected risk of claim choose to opt out of cover;
 - (f) exposure of the insurer to catastrophe risk through a concentration of insured lives in a single location;
 - (g) high aggregate exposures to individuals who obtain insurance under several policies. The insurer may not be able to monitor or reinsure these exposures if it has inadequate data on the individual members of group schemes;
 - (h) operational and insurance risks arising from the outsourcing of insurance management functions to an RSE licensee or administrator. Outsourced functions may include the assessment of eligibility for cover, claims management, data management and claims decisions¹;
 - (i) operational risks associated with the outsourcing of member services to the insurer by an RSE licensee. The insurer may be responsible for notifying members of the commencement and termination of coverage and of any special conditions applying to their benefits. The insurer may be responsible for providing and maintaining systems that allow members to enquire about their benefits, to apply for additional cover or cancel their existing cover. APRA expects the insurer would ensure that all communications and systems accurately reflect the terms of the insurance contract;
 - (j) operational risks associated with the need to recruit additional administration staff with appropriate experience and expertise if the insurer is successful in taking over a large group scheme; and
 - (k) legal risks relating to takeover terms when an RSE licensee transfers a group scheme from another insurer. These terms specify when the insurer becomes responsible for claims and the acceptance terms on which it takes over the cover.
5. Gaining or losing a large group life scheme can result in sudden and significant changes to the risk profile of an insurer. The risk management framework may need to be reviewed in response to these changes.

¹ Refer to paragraph 22 for further guidance in relation to outsourcing of claims decisions.

Insurance tenders

6. Group insurance is often arranged through a tender process. APRA expects a potential insurer to address the following issues in its response to a tender:
 - (a) the insurer's claims philosophy (an RSE licensee must consider an insurer's claims philosophy according to SPS 250);
 - (b) the cost of insurance and the other terms and conditions of the insurance contract. These include takeover terms, profit-sharing, automatic acceptance limits, eligibility requirements, underwriting requirements for optional cover or cover in excess of the automatic acceptance limits, and premium loadings and benefit exclusions for substandard lives;
 - (c) the sustainability of the premium rates and terms and conditions of the insurance contract beyond the initial guarantee period;
 - (d) the services offered by the insurer under the agreements accompanying the insurance policy, including claims and data management, underwriting and reporting provisions; and
 - (e) the terms of any outsourcing of functions to an administrator or other entity.

Some of these issues are discussed in the following paragraphs.

Claims philosophy

7. An insurer's claims philosophy should capture the insurer's approach to claims assessment, administration and settlement. This would include its expectations of claimants (e.g. in respect of the burden of proof of disability), the nature of support given to claimants, processes to be followed by the claimant and communication with the claimant. APRA expects the insurer's claims philosophy to be clearly articulated. In particular an RSE licensee should be able to understand the insurer's practical application of the definition of disablement.
8. Claims philosophy encompasses those processes of the insurer that support procedural fairness for claimants. Examples of how procedural fairness might be supported by an insurer include, but are not limited to:
 - (a) the insurer having formal service levels for processing claims and reporting against those service levels;
 - (b) the insurer having in place a process to ensure that all relevant information has been provided to it and a process that supports the appropriate review of previous decisions when new information comes to light;
 - (c) the insurer having in place a process for providing beneficiaries with access to all material that has influenced the claims decision and the opportunity to respond and/or provide further information;
 - (d) the reasonableness of the insurer's claims requirements (and underwriting requirements if relevant);
 - (e) the insurer's process for paying interest on claims;
 - (f) the insurer's awareness of case law that might affect its decision making processes; and
 - (g) the dispute resolution procedures between the insurer and RSE licensee where there is disagreement regarding claims assessments.
9. APRA considers it to be good practice for the insurer to support the articulation of its claims philosophy with indicators such as:
 - (a) the insurer's rate of rejection of claims;
 - (b) the insurer's record of claims decisions being overturned by the Superannuation Complaints Tribunal or a court;
 - (c) the insurer's processes for monitoring the quality of claims decisions; and
 - (d) the training and skills of the insurer's claims assessors.

Other information that might be relevant includes de-identified details of specific examples of claims paid and claims denied.

Terms and conditions

10. In order to satisfy the requirements of SPS 250, the terms and conditions of an insurance contract with an RSE licensee must, at a minimum, address:

- (a) the level and type of insured benefits made available, including any exclusions;
- (b) the term of the insured benefits;
- (c) automatic acceptance limits (to the extent relevant);
- (d) availability of opt-in and/or opt-out cover;
- (e) requirements for the beneficiaries' eligibility for, cessation of, and any reinstatement of entitlements to insured benefits where available;
- (f) premium structure, including any variable components; and
- (g) review, termination and renewal provisions for the insurance arrangement.

The contract must also address those aspects of service provision listed in paragraph 15.

Sustainability

11. APRA expects an insurer's response to a tender to discuss the potential for future changes to the premium rates and the other terms and conditions. This is particularly important if there is a significant likelihood that future changes will have a materially adverse impact on beneficiaries.

12. It is also important for an insurer to consider the potential impact of a new group insurance arrangement on its own financial and other resources. This includes consideration of matters such as:

- (a) the amount of capital required;
- (b) availability of capital; and
- (c) availability of a suitable administration system and experienced claims management, underwriting and administration staff.

13. The amount of capital required will depend on the level of uncertainty around future experience. The level of uncertainty is affected by a number of factors including:

- (a) the size of the scheme, its membership profile and the range of benefits provided;
- (b) the quality of the experience data provided by the RSE licensee;
- (c) any changes to benefit design (e.g. increases to automatic acceptance levels, changes to the definition of disablement) or membership profile;
- (d) differences between the claims philosophy of the tendering insurer and those of previous insurers of the scheme;
- (e) reinsurance arrangements;
- (f) profit-sharing arrangements;
- (g) continuation options;
- (h) takeover terms;
- (i) the rate guarantee period; and
- (j) risks, including those set out in paragraph 4.

14. APRA expects that any reinsurance arrangements would reflect the insurer's risk appetite and be aligned with the terms of the insurance contract (e.g. with regard to guarantee periods). Insurers also need to consider the counterparty risks associated with reinsurance exposures.

Service agreements

15. In order to satisfy the requirements of SPS 250, an insurance contract with an RSE licensee and/or an accompanying agreement must address the following aspects of service provision:

- (a) procedures for notification and payment of claims;
- (b) agreed service standards;
- (c) reporting requirements for monitoring agreed service standards;

- (d) the provision of data to the RSE licensee on an annual basis, including claims experience, membership, sums insured and premiums paid;
 - (e) dispute resolution arrangements; and
 - (f) liability and indemnity arrangements.
16. APRA considers that it would be sound practice for the service standards to cover, at a minimum, the timeframes for:
- (a) processing of underwriting of applications for insurance and the communication of the outcome of underwriting decisions to beneficiaries;
 - (b) the provision of relevant member and claims information to the insurer;
 - (c) processing claims, including the time taken to undertake the initial assessment of a claim;
 - (d) claim decisions once all relevant information has been received; and
 - (e) payment of admitted claims.
17. APRA expects that the dispute resolution arrangements would cover the management of disputes between the RSE licensee, the insurer and any other parties such as an administrator. The matters that APRA would ordinarily expect to be covered include, at a minimum: how disputes relating to claims, eligibility, underwriting, premium payment, renewal, data and service standards are determined or resolved, including how a dispute is to be escalated.
18. APRA expects that an insurer and RSE licensee would also have documented arrangements in place, prior to the commencement of risk, which address matters including, but not limited to:
- (a) eligibility for insurance cover and underwriting requirements, including the responsibilities of the insurer, the RSE licensee or the administrator with respect to underwriting;
 - (b) restrictions to benefits and premium loadings i.e. exclusions or extra premiums charged to a member or group of members based on specific conditions, including how members are notified about additional premiums;
 - (c) procedures for deducting premiums from members' accounts and paying premiums to insurers;
 - (d) procedures for notifying and paying claims, including the responsibilities of the insurer when communicating directly with beneficiaries;
 - (e) continuation options or transfers between categories of membership, including notification to beneficiaries;
 - (f) liability and indemnity where the insurer outsources a material business activity relating to the insured benefits;
 - (g) liability and indemnity where incorrect data has been relied upon; and
 - (h) profit-sharing arrangements and experience commission terms, including their consistency with the undertaking provided by the RSE licensee under s. 29SAC of the SIS Act not to charge members with an interest in a MySuper product for payment of conflicted remuneration.
19. An insurer would need to consider whether a proposed profit-sharing arrangement would result in a contract being classified as participating according to the *Life Insurance Act 1995* and *Prudential Standard LPS 600 Statutory Funds*.
20. APRA expects that an insurer would take reasonable steps to avoid offering an arrangement that could be regarded as self-insurance to an RSE licensee that is not permitted to self-insure under the SIS Act.

Outsourcing

21. All outsourcing arrangements involving material business activities entered into by an insurer must be subject to appropriate due diligence, approval and ongoing monitoring as required by *Prudential Standard CPS 231 Outsourcing*.
22. APRA does not consider the outsourcing of claims decisions to be good practice. Claims decisions are financially significant for an insurer and can require the exercise of expert judgement. In addition, the outsourcing of these decisions to the RSE licensee (or a third party acting on its behalf) could create a conflict of interest.

Monitoring the RSE licensee and other relationships

23. APRA considers that appropriately detailed and frequent reporting between the insurer, the RSE licensee and other parties (such as an administrator) involved in the management of insured benefits is crucial for managing the risks related to making insured benefits available to RSE beneficiaries.
24. APRA expects reporting to include information on emerging experience. It is particularly important to identify any adverse trends that could affect the sustainability of the terms and conditions of the contract beyond the end of the current guarantee period.
25. APRA expects that the insurer would have in place mechanisms to assist the regular review of its processes by the RSE licensee. This review can support the accuracy of premiums charged and claims data, and compliance of the insurer with service agreements. APRA expects that the insurer would also have mechanisms to review any processes carried out by the RSE licensee or administrator that the insurer relies upon.

Responding to a tender

26. If a significant commitment of resources would be needed to respond to a tender, it is good practice for the insurer to have in place a process for assessing the potential costs and benefits before making this commitment.
27. *Prudential Standard LPS 320 Actuarial and Related Matters* specifies that a life company must not issue a policy unless the Appointed Actuary has given written advice about the proposed terms and conditions of the contract, including any associated reinsurance arrangement. For group insurance tenders, the insurer typically makes a binding offer to the RSE licensee well before the policy is issued. APRA expects the Appointed Actuary's advice to be received and considered by the life company before any such offer is made.
28. For large group insurance tenders the insurer may decide to vary its standard pricing policies and procedures. APRA expects that if the Appointed Actuary's advice is not followed or if there are variations from standard pricing policies and procedures, these matters will be adequately documented and will be approved at the appropriate level of the company. The appropriate level may be the Board if the variation is sufficiently material.
29. APRA considers it good practice for the insurer to consider withdrawing from a tender if the time allowed for a response is insufficient for the insurer to properly consider and price the risks. Alternatively, a quotation can be made on an indicative basis with the cost of insurance and other terms and conditions subject to confirmation at a later date.

Data management

30. SPS 250 requires an RSE licensee to maintain records of the claims experience, membership, sum insured and premiums paid for the insured benefits for at least the previous five years. This information is important to support the tender process and orderly transition where an RSE licensee enters into an agreement with a new insurer to provide the insured benefits. The records must be of sufficient detail to enable a prospective insurer to properly assess the insured benefits that are made available. Accurate claims records also support the identification, monitoring and management of the risks associated with making insured benefits available to beneficiaries.
31. An RSE licensee may allocate specific responsibility for the maintenance of this data to the insurer or administrator, although the RSE licensee is ultimately responsible for complying with the requirements in SPS 250.
32. APRA expects the insurer to provide all necessary support to an RSE licensee and/or the administrator in order to ensure that the RSE licensee can comply with SPS 250. This includes provision of advice on the specific items of data to be maintained.
33. The insurer will need to maintain claims experience information for its own purposes such as the determination of liabilities and capital requirements, even if the insurer has not been allocated the responsibility for maintenance of this data by the RSE licensee. The data maintained by the insurer may need to include data in respect of claims incurred under earlier contracts with the RSE licensee, even if those contracts were with other insurers. The current insurer should be able to obtain updates to this data on a regular basis from the RSE licensee.
34. If the insurer maintains claims experience information on behalf of an RSE licensee, APRA expects the information to be available to the RSE licensee in a format all potential users of the information can use and understand.
35. Whilst SPS 250 makes specific reference to data for at least the previous five years, APRA considers that prudent insurers and RSE licensees would maintain information over longer periods. APRA expects insurers and RSE licensees to consider the historical run-off pattern of claims when determining the length of time for which records are maintained. APRA considers it good practice for insurers to continue to maintain data in respect of each insurance arrangement beyond the expiry of insurance risk, until it is likely that the last claim payment has been made.
36. APRA expects insurers and RSE licensees to maintain records of sufficient detail, currency and accuracy to support both the assessment and management of the provision of insured benefits and the associated risks. This information would usually include complaints data, take-up rates of opt-in and opt-out arrangements and requests for additional cover and their outcome. Where this information is maintained by an insurer on behalf of the RSE licensee, APRA expects that the insurer would provide periodic reporting on and/or allow the RSE licensee access to relevant insurance information.
37. APRA also considers it important for insurers and RSE licensees to maintain a history of the pricing and design of insured benefits and membership as they have evolved over time. This includes:
 - (a) changes in the type and level of insured benefits made available, as well as associated advice to beneficiaries regarding changes to their cover;
 - (b) significant groups of beneficiaries joining or leaving the insurance arrangement, such as those employed by a particular employer that enters or leaves the RSE, or successor fund transfers;
 - (c) changes to insurance processes - for example, changes to administration systems, changes in marketing methods, bulk adjustments, special offers to alter the terms of insurance or changes that result in claims being reported earlier or later; and
 - (d) changes in automatic acceptance limits.

Data used in tenders

38. APRA considers it to be good practice for a prospective insurer to carry out validation and reasonableness checks of all data that they rely on. It is not good practice to assume data is complete and free of error, even though the RSE licensee has a duty of disclosure and a requirement to act in the utmost good faith under the *Insurance Contracts Act 1984* (Contracts Act).
39. SPS 250 allows transitional arrangements for RSE licensees until 1 July 2016 with respect to the requirement to maintain at least five years of data records. Insurers participating in tenders prior to this date should be aware that RSE licensees may not be able to provide five years of data records.
40. APRA considers it to be good practice for an insurer to make allowance for any uncertainty relating to the quality of the data in the terms and conditions of the insurance offer. APRA expects that an insurer would assess the level of uncertainty regarding future claims experience and the amount of capital required to support the insurance contract. At the extreme, a potential insurer may need to consider withdrawing from the tender if the level of uncertainty and the capital requirements are excessive.
41. APRA does not consider it to be good practice for an insurer to waive its rights under the Contracts Act to take remedial action if the data it relied on is subsequently found to be incomplete or incorrect.



Telephone
1300 55 88 49

Email
info@apra.gov.au

Website
www.apra.gov.au

Mail
GPO Box 9836
in all capital cities
(except Hobart and Darwin)