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Director, Superannuation Efficiency and Performance Unit
Retirement, Advice and Investment Division
Treasury
Langton Cres
Parkes ACT 2600
By email: YFYS@treasury.gov.au

Dear Director

REVIEW OF YOUR FUTURE, YOUR SUPER MEASURES

We appreciate the opportunity to provide feedback on the review of the Your Future, Your Super (YFYS) measures. We have focused our response on how these measures have impacted insurance in super, particularly where there are unintended or undesired outcomes.

In relation to stapling, we are conscious of criticisms of stapling and its impact to insurance cover and our response seeks to provide our practical experience as a leading group insurer across all sectors of the superannuation industry.

Performance test

5. Is there evidence to indicate that the notification and website publication requirements have been effective at encouraging members to consider, and switch to, alternative products? Are there ways this could be improved?
The notification sent to members, which encourages them to consider switching to an alternative product when their fund fails the performance test, could be improved. The prescribed content of this notification does not provide information about the member's insurance or the potential consequences on that insurance of switching to an alternative product. While the notification should not act as an impediment to a member considering a better performing fund, it is important members consider the material implications of any switch. We recommend this extend beyond just investment performance and fees, to also include insurance. The prescribed content of the notification could include a variable paragraph for insured members. This would alert them to consider their insurance, for example whether the new fund might impose a period where pre-existing conditions are not covered. Members could be directed to an enhanced YourSuper comparison tool for more information (explained in more detail in the response to Q11 below) or to read the relevant fund PDS.

YourSuper comparison tool

11. To what extent would altered or additional metrics, or improved functionality, make the tool more effective while ensuring it remains simple and clear? What more can be done to ensure that new employees are able to choose high-performing superannuation product that are appropriate for their needs?
The YourSuper comparison tool could be enhanced to prompt members to consider insurance, as one of the material factors of choosing any super fund, particularly when switching. Providing a comparison between insurance in different funds has proven problematic in the past given the many variables that need to be considered. This has likely delayed the inclusion of insurance in APRA heatmaps or in product dashboards. Data on default cover and cost is collected by APRA, however we have previously noted concerns[1] about the comparability of the cost data points in particular, as these can be skewed by differences in the average occupation of the membership and in terms and conditions. Without appropriate qualification or context, it's likely this information would be misleading if published. The YourSuper tool could prompt the member to consider key questions to make sure cover in the new fund is suitable. This might include: • eligibility, and any pre-conditions such as minimum balances to make sure there is no period without cover • whether there is a period during which existing health conditions might not be covered, and • whether their occupation has any impact on their cover, for example eligibility, cover amount or premium. Members could be directed to the relevant PDS or Insurance Guide or to call the fund to answer these questions. This avoids situations where members switch to a better performing fund and take advantage of better performance but suffer a detriment if they need to claim in future.

Stapling

16. What is the actual, or likely, impact of stapling on insurance coverage?
The impact of stapling on insurance coverage was always expected to be a 'slow burn' because it is only felt when members change jobs. The main impacts for insurance cover that were expected at the time the YFYS measures were passed included: 1. changes to the occupation mix of a fund's insured population 2. the risk of selection bias – as more people choose their insurance cover motivated by health events rather than being defaulted into cover; and 3. the risk of being unable to claim against cover due to changes in occupation. Anecdotally, we understand there is a degree of non-compliance by employers with the stapling obligations, which has further masked the true impact of stapling on insurance. Over time it is expected that a fund's insured population will trend towards the general population, as more members stay with a fund when changing jobs. This will have a gradual impact on pricing (both negatively and positively), as an insurance pool increases or decreases its overall risk profile. This would be managed as part of the regular review cycle (typically every two or three years) when trustees would also consider the default benefit design to reflect changes in membership demographics. The risk of selection bias, where members are choosing to opt-in for insurance driven by health events that increase the likelihood to claim, has largely been mitigated by changes made to insurance coverage when the Putting Members' Interests First (PMIF) reforms commenced. PMIF introduced increased 'choice' and greater risk of selection bias into insurance in super, and policy terms and/or pricing was adjusted accordingly. The risk of members in more dangerous occupations being unable to claim against cover was identified as

[1] AIA Australia submission to APRA consultation on *Superannuation Data Transformation – publications and confidentiality*, April 2022

an emerging issue. This is because some policies include occupation-based exclusions or restrictive disability definitions to manage risks for the broader membership. Stapling would have exacerbated this issue, as members who move into a more dangerous occupation would stay with their existing fund creating a risk that occupation-based exclusions could be triggered.

However, in response to this risk, the FSC's superannuation members and group insurers agreed to prohibit the use of these occupation exclusions and restrictive disability definitions based on occupation in default cover. The FSC's Standard 27[2] was released in December 2021 with a 12-month transition period. While the Standard is only binding on FSC members, all group insurers are prohibited from proactively offering these terms to any trustee, creating a powerful industry norm. The benefit of the Standard applies to any insured member with default cover, not just those who may have changed occupations after stapling commenced which improves insurance for all members.

Our own experience has seen a strong willingness to adopt the Standard by trustee partners whose policies included these terms. All of our partners have committed to removing these terms, with the majority on track to finalise this within the transition window. Several trustees are in the process of merging, and this has complicated the timing of this change, but otherwise remain committed.

Some commentators have raised concerns that one of the impacts of Standard 27 would be a reluctance for trustees to offer cover to those in more dangerous occupations because they can no longer deny cover if they claim. In practice, this risk hasn't materialised. One of the structural challenges trustees face is not knowing a member's occupation, particularly when they join. A fund can only exclude members in more dangerous occupations from default cover if this information is available when they otherwise become eligible for insurance cover. For example, when meeting the PMIF age and balance threshold. If this information is not held at that time (representing the overwhelming majority), funds can't exclude members from cover. If cover is provided automatically, they are protected by the operation of Standard 27.

With the creation of the Council of Australian Life Insurers (CALI), which will see most life insurers leave the FSC, CALI has committed to its members remaining bound by relevant standards and the Life Code so members will continue to benefit from the protections that Standard 27 offers.

Best financial interests duty

18. Are there certain types of expenditure or activity that trustees are particularly concerned about being able to prove compliance with the BFID in respect of? Why is it difficult to demonstrate compliance? Should there be a materiality threshold?

One of the challenges trustees face is expenditure on insurance benefits. Many trustees have redesigned their default benefits over recent years to reduce the erosion of superannuation balances. Sustainability is also an important consideration and ensuring benefits can support members to return to wellness or work are important in reducing the cost and improving sustainability.

Paragraph 3.30 of the explanatory memorandum (EM) to the YFYS legislation notes "*financial interests of members may include insured benefits (including death benefits or total and permanent disability coverage) provided in accordance with a properly formulated insurance strategy"* and *"subject to the trustees complying with the sole purpose test, this does not preclude trustees undertaking actions that also yield non-financial benefits to the beneficiaries, but the action cannot compromise the best financial interests of the beneficiaries. How any action will yield financial benefits to the beneficiaries of the superannuation entity must be the determinative consideration for any trustee."*

The above should provide clarity to trustees that insurance in super yields financial benefits to members. However, Example 3.1 in the EM specifically references the spending of beneficiaries' funds on wellbeing and counselling services.

[2] https://www.fsc.org.au/web-page-resources/fsc-standards/2430-fsc-s27-2

"Example 3.1- Expenditure not in the best financial interests of beneficiaries

Yellow Super has decided to spend an amount of beneficiaries' funds in wellbeing and counselling services due to its preference for providing beneficiaries with a holistic retirement experience. While beneficiaries derive some benefits from these services, they are not financial benefits and offering the services comes at financial cost to the fund. This expenditure is unlikely to be in the best financial interests of the beneficiaries."

This has created ambiguity for trustees given the extent of wellbeing services, such as return to work and wellness services or occupational rehabilitation, which are bundled with the group insurance offering. For clarity, the services and programs above are included in the premiums paid by the fund to its group insurer. Costs incurred to provide these services or programs are incurred by the insurer but are expected to be more than offset by lower claims costs.

One focus of these programs is on improving the sustainability and affordability of insurance. These services are intended to reduce the incidence of illness or injury occurring, or the severity if an illness or injury was to occur. While this undoubtedly will reduce claims costs for the insurer, in a group insurance context there is shared value as the benefits flow to the trustee and beneficiaries through lower premiums. Members and claimants will be able to contribute more to their own retirement savings over a longer and more productive working life.

This ambiguity means that trustees find it more challenging to satisfy their best financial interest duty, and in some cases are electing to remove these ancillary services from their core offering.

We'd recommend that a distinction is drawn between expenditure on insurance premiums, which may include wellbeing services such as return-to-work support and occupational rehabilitation, and **those incurred by trustees directly** in providing the wellbeing and counselling services referred to in Example 3.1.

To address any ambiguity or uncertainty about the nature of expenditure on insurance premiums, we recommend further guidance is provided to trustees. This could be via an additional example - our proposed drafting is below.

Example xx - Insurance premium expenditure with financial and non-financial benefits in the best financial interests of beneficiaries.

Purple Super acquires insurance from a life insurer for its MySuper beneficiaries. The insurance is designed to provide beneficiaries with financial benefits in the event of death or disablement. The board has determined that the types and levels of cover acquired are appropriate for beneficiaries and that the costs do not inappropriately erode the retirement incomes of beneficiaries.

The insurance acquired by Purple Super also provides other non-financial benefits to beneficiaries, including programs designed to support health and wellbeing for members, and rehabilitation and return-to-work support for claimants.

This expenditure is likely to be in the best financial interests of beneficiaries.

Should you wish to discuss any aspects of our response please do not hesitate to contact Tom Gordon, Head of Regulatory Affairs in the first instance on tom.gordon@aia.com or 0404 059 808.

Yours sincerely

Damien Mu
CEO and Managing Director
AIA Australia