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## **Superannuation**

Productivity Commission  
Locked Bag 2, Collins Street East  
Melbourne Vic 8003

### **Productivity Commission Draft Report: How to Assess the Competitiveness and Efficiency of the Superannuation System**

As one of the largest life insurers in Australia, AIA Australia recognises the importance of an efficient superannuation system in helping Australia meet the economic and fiscal challenges of an ageing population. We believe that this is an important review and will set the foundation for the continued evolution of this important industry and will help to ensure that all Australians are adequately prepared for retirement.

The funding of life insurance premiums within superannuation is a major vehicle for affording millions of Australians with cover, and protecting Australians' retirement savings should they suffer loss through death or disablement. The introduction of MySuper mandated that trustees provide Death and Total and Permanent Disablement (TPD) benefits on an automatic basis with the ability for members to opt-out of insurance within their MySuper product. We are strong supporters of the superannuation industry in providing products and services that help members prepare for retirement and protect themselves against the risks of premature death or disablement.

Last year alone, Australian super fund members received \$4.38 billion in insurance claims benefits through their insurance cover<sup>1</sup>. Many Australians who claimed through their superannuation also received occupational rehabilitation and return to work support to assist them in getting back into the workforce.

From this perspective, group life insurance provides a valuable social and economic benefit in assisting members to cope with unexpected illness or injury, or premature death, often where the individual may not otherwise have chosen, or been able, to take out life insurance. Many of these members would otherwise be reliant on social security or other welfare benefits as their safety net. Life insurance, therefore, helps to transfer financial risk from the public sector to the private insurance industry and minimises the impact that these events may have on the Government and Federal Budget. Research undertaken by Rice Warner has found that the costs of underinsurance to government is almost \$2 billion annually<sup>2</sup>. Group insurance reduces the annual cost to Government of social security by about \$403 million<sup>3</sup>.

Life insurance is also valuable in helping to reduce reliance on the Age Pension by enabling members to continue to save for their retirement while recovering from health setbacks, and assisting members to re-join the workforce through associated initiatives including return to work and occupational rehabilitation programs.

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<sup>1</sup> APRA Annual Superannuation Bulletin June 2015

<sup>2</sup> Rice Warner, Insurance Administration Expenses, August 2014

<sup>3</sup> ASFA Media Release, Group Insurance reduces government spending on social security by \$403 million annually: new ASFA report, published 28 August 2014

However, we acknowledge that there are opportunities to enhance the operation of life insurance within superannuation. Trustees, regulators, and insurers must constantly seek an appropriate balance between the type of benefits offered, the level of cover required to meet members' needs, and the impact of premiums on superannuation accumulation. While the payment of \$4.38 billion in claims benefits is a result of the successful balancing of these interests, there remains opportunity to improve the overall value that life insurance can contribute to the superannuation system and, in turn, society.

AIA Australia welcomes the opportunity to provide feedback on the proposed assessment approach of the Productivity Commission, particularly with reference to the draft criteria and indicators.

Given the complexities and interdependencies of insurance inside superannuation, subtle changes can have significant unintended consequences. Careful consideration by the industry can ensure that we avoid unintended consequences, and at the same time identify and action necessary improvements to the system.

To that end, AIA Australia believes that carefully framing the objectives, criteria and indicators of the report is vital to ensure that the results provide relevant and productive insights into the efficiency of the superannuation industry. This will help to promote our continued focus on delivering better value and protection for Australians.

Our response is separated into three Parts as follows:

- Part 1 outlines AIA Australia's position in the market and provides insight into a typical day of a group life insurer;
- Part 2 highlights the importance and benefits of life insurance within superannuation, and identifies opportunities for enhancement; and
- Part 3 details AIA Australia's recommendations with respect to the proposed objectives, criteria and indicators of the report.

This review is an important opportunity for our industry to collaborate, understand the various perspectives of different stakeholders, and determine a course of action that will improve competition and efficiency in the superannuation industry while delivering outcomes that are in the best interests of all Australians. We look forward to working with the industry and Government in pursuit of improved outcomes in the Australian superannuation system.

Should you have any questions, or wish to discuss this further, please contact me personally by email

Kind regards,

Damien Mu,  
CEO, AIA Australia

## Part 1

### About AIA Australia

AIA Australia Limited is an independent life insurance specialist with over 45 years of experience building real and sustainable partnerships. AIA Australia is part of the AIA Group, a market leader in life insurance across the Asia Pacific region with over 90 years' experience.

AIA Australia offers a range of products that protect and enhance the lives of over three million Australians and is widely recognised as a market leader in product innovation and development.

AIA Australia is Australia's largest group life insurer by market share<sup>4</sup> and works closely with major financial institutions and corporate partners to provide life insurance solutions for our customers. In addition, AIA Australia is ranked number 1 in new sales to independent financial advisors in the retail advice market<sup>5</sup>. AIA Australia also works with a network of affinity partners that distribute life insurance products. By having a partnership philosophy at the core of our business, AIA Australia is focused on building genuine relationships and delivering real value to our business partners.

The reach of AIA Australia's operations places us in a unique position to create economic and social benefits for our shareholders, customers, partners and society. As a life insurer, we look at ways that we can proactively improve the lives of people who suffer or are at risk of suffering from specific illnesses, while also improving our competitiveness as a business.

In March 2014, AIA Australia introduced 'Vitality' – the world's leading scientifically-backed health and wellness program - to the Australian market. AIA Vitality aims to be a catalyst for real change to improve the health and wellbeing of Australians. Through AIA Vitality, we are able to incentivise improved health outcomes for our customers, reducing claims costs and improving policy retention rates as an outcome – sharing the benefits back to customers through reduced premiums. Additionally, our claims philosophy focuses on 'ability rather than disability' by helping those who claim return to work, where possible. Along with other occupational rehabilitation and work readiness initiatives such as RESTORE (which is a work readiness and wellness program aimed at the effective management of mental illness claims), we can further improve the wellbeing of our customers and not just pay claims.

This is all part of our overarching operating philosophy to do 'the right thing, in the right way, with the right people'.

### Taking a closer look – a day in the life of group insurance

Insurance is an essential part of every Australian's life. It is not something which is used every day, and some people may never need to make a claim. It provides members with peace of mind, knowing that there is something to fall back on should the unexpected or unfortunate occur.

It is when the unexpected or unfortunate occurs that insurance provides its greatest value. AIA Australia is proud of the work that we do, and what our industry gives to Australia 365 days a year. We will continue our efforts to support individuals and families through their toughest times through our return to work and occupational rehabilitation initiatives and benefits payable.

AIA Australia would like to provide the Productivity Commission with some insight into the support provided by group insurance to Australians on an average day, so that it can appreciate the positive impact group insurance has on the lives of individuals and their families.

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<sup>4</sup> NMG Group RDM Q2 2016

<sup>5</sup> NMG, IFA Channel Risk Distribution Monitor April – June 2016, (published August 2016), Page 16, rolling 12 month new sales by manufacturer

At AIA Australia, we understand that every claimant is unique and focus on open communication, as well as high levels of service and support, so that we can tailor a solution that best meets the needs of each individual. Embedded in our claims philosophy is a focus on ability, rather than disability, and the knowledge that claimants need both our sensitivity and professionalism. This guides the interactions we have with our clients every day.

By way of example, on 26 August 2016 AIA Australia paid benefits relating to over 300 claims, to a value of \$3.8 million. This is only a small part of the \$1,029m in claim benefits paid to AIA Australia customers in 2015. We took a snapshot of 10 claims to put into context the value of the work we do everyday as a life insurer, and the difference we are making to everyday Australian members.

## Case Study Examples

Please note that in the interest of privacy and confidentiality member details have been substituted.

### **Total and Permanent Disablement and Income Protection**

Group insurance gives us the opportunity to make a positive, lasting impact by helping improve a member's quality of life and by easing ongoing financial burdens. Through our Total and Permanent Disablement and Income Protection products we deliver outcomes that assist our members through difficult periods.

#### Kevin

Kevin is a 31 year old working as a labourer and forklift driver approximately 62 to 70 hours per week. In 2009, Kevin was inspecting a pipe for damage when a nearby forklift hit his ladder causing him to fall onto a concrete floor and damaging his knee. Kevin continued to work for the next two years, struggling with the pain of his injury and consequent depression. A keen car racer, footballer, water skier and motorbike rider, Kevin found that his knee problems stopped him from taking part in the pursuits he loved. Kevin continued to try and work, even picking up another role as a welder and forklift driver that he figured would not put as much pressure on his knee. After a near accident when his knee locked, he stopped work and driving altogether. At the age of 31, with a work history in purely manual labour, Kevin was deemed to be totally and permanently disabled. Kevin was paid \$175,000 through his group insurance, money which he can use to help him prepare for the next stage of his life.

#### Jane

Jane was working 25 hours per week and had been in the same job for over 28 years, working nightshift stocking shelves and cleaning stockrooms. This had been her first job back in the workplace after leaving her previous job to get married and have kids in the early 1970s. As she aged, she gradually reduced her hours as her physical condition began to deteriorate and made the demands of her job unbearable. Now, her physical deterioration has left her unable to attend concerts, go to the beach, or even play with her grandkids. The sharp pain in her knee after her left foot got stuck under a trolley pallet in 2013 started the downward spiral for her and when she suffered a fall in July 2015 at work, she found her employment terminated as she posed too much of a risk to herself and her colleagues. At 62 years old, we hope the payment of \$26,000 will assist Jane as she transitions into retirement.

### **Total and Permanent Disablement and Income Protection – Mental Health**

Total and Permanent Disablement is often associated with physical injuries, however, mental health is something that Australia is becoming gradually more aware of and understanding of. Unfortunately, someone's mental health can deteriorate to the point where they are deemed to be totally and permanently disabled.

#### Andrew

Andrew's original claim was for a heart attack. In his claim form he made a passing reference to having poor concentration and some depression/anxiety. As the claim progressed, we found that he had been diagnosed with Bipolar Affective Disorder at the age of 19. While his heart attack had certainly caused him some temporary physical issues, it was the depression and anxiety that was proving to be the problem for this member being able to return to the

workforce. The mental health issues were leaving Andrew with low motivation and energy, as well as a sense of worthlessness. As the physical condition improved, his mental health only got worse to the point where he had difficulty in being able to shower or dress himself. Working as an Optical Technician, Andrew had a good job with his family business but his mental health precluded him from being able to engage with the public and to do the job that he had trained for. Despite the highly sedentary nature of his role, his mental health had deteriorated to the point that AIA Australia paid this 57 year-old \$30,750 with the potential for this to rise to \$57,000 if he remains disabled.

### **Total and Permanent Disablement and Income Protection – Returning to Work**

With Income Protection, our aim is to provide the support, both short-term and long-term, to help our Members get back to work and give them the financial backing to let them focus their energies and their attention on getting themselves better.

#### Louise

A security guard by day, Louise also plays soccer in her spare time. After coming off second best in a tough tackle, she was admitted to hospital with a fracture to her left leg and was unable to work as a result. Louise was left in a CAM boot and unable to walk or respond to emergencies. Her employer made it clear that they were unable to take her back until she regained full fitness. Louise was able to claim from SportsCover Australia owing to the circumstances of her injury, but their payment was not enough to support her. We made an assessment that Louise was likely to be off work for another few months. After offsetting the SportsCover payment, AIA Australia paid an additional \$1,833.57 per month to Louise while she completes her rehabilitation with the goal of returning to work.

#### Lorraine

Lorraine was diagnosed with a rare auto-immune disease in 2012. She was left with numbness in both legs and poor balance – this left her unable to walk and with pain that radiated into her back. She found that she was unable to work in her role as a cashier. Aged 50, and with an uncertain prognosis, Lorraine was faced with a condition that was likely to spread to her spinal cord, and leave her with a loss of vision. AIA Australia supported Lorraine financially with \$1,750 per month that compensated her for loss of earnings. This financial and return to work support we provided, along with her own willpower and determination, helped Lorraine to return to work on a partial basis. Lorraine returned to work over three years ago, but AIA Australia have continued to support her with an ongoing benefit because she has been unable to work at her pre-disability level. Each month we have supplemented her income so that she is not financially disadvantaged from trying her best to get back to work. Now, Lorraine has increased her hours to 12 per week, and is continuing to increase her capacity while we continue to support her pursuits.

### **Terminal Illness Benefit**

Terminal Illness benefit gives us the opportunity to make a difference to someone's life before it reaches an end – giving them the comfort and reassurance that their families will be looked after and their financial affairs have been settled. Sadly, we are not always able to be there before the end, which is why AIA Australia places huge importance on making decisions on death claims as quickly as possible, to help ease the financial and emotional burdens that death so often brings.

#### Diana

Diana is a 57 year old nurse who was advised by her doctors that she had less than 12 months to live. Her job involved caring for others and helping them through their darkest hours – providing much needed support for those in physical and emotional pain. We are proud to say that when it was time for us to care for Diana, we did exactly that – approving immediately her terminal illness claim and making a payment for \$80,000.

#### Steven

Despite our best efforts, we are not always able to get there in time. We commenced our assessment of Steven's Terminal Illness claim upon receipt, and were looking to complete the necessary requirements when his doctor contacted us to let us know that he had passed away

from his lung cancer. This was only four days after completing the paperwork. One of the last things Steven did was to take steps to claim on his insurance to help provide for his family. To avoid any further stress or upset to the family, we moved immediately to make payment on a death claim to release the \$35,000 to his estate without any further delay.

#### David

Starting out as a milkman, David ended up working alongside his father in the branch of an electronics store that he managed. This proved to be the most worthwhile decision he ever made. As well as getting to work with his dad, he also met his first wife Laura at the store, and together they had three children. David eventually took the reins of his own branch of the store and, after another relationship which brought his fourth child into the world, in 2012 he married his second wife, who he also met through the course of his work. Unfortunately, later that year, David was diagnosed with cancer. Keen to support his family, David continued to work for over three years until the spread became too great. After a prolonged battle, David died leaving behind his new wife and his four children. We made sure David's family was supported and provided for by paying his next of kin a benefit of \$273,500.

#### Maria

Maria worked as a tour boat operator and tragically drowned following a workplace accident, leaving her friends and colleagues devastated. Upon receipt of the required documents, we moved quickly to settle the claim and ensured that her next of kin received \$209,000 to help settle her estate and begin the journey of recovery.

#### Tom

Tom is an 18 year old Vehicle Cleaner. At the age of 14, with his whole life still in front of him, Tom was diagnosed with cancer. Tom, like so many people do, fought bravely and forced the disease into remission. Unfortunately, over four years later the disease returned and had spread to the point where he is unlikely to see his next birthday. Though money can never replace the lost years, or repair the heartache suffered by Tom and his family, the \$131,500 in default insurance obtained through his superannuation have helped this young man cope with something that no amount of preparation can begin to ready you for: being told that you have less than six months to live. Given his medical history, Tom would have found it impossible to obtain any form of insurance outside of insurance provided through superannuation.

#### **Conclusion**

Our research indicates that almost one in two of those with life insurance through superannuation believed they would not be covered if it was not provided automatically.<sup>6</sup> This means that up to half of the members above who received benefits would have been left without recourse in their time of need. This clearly demonstrates the indescribable value of default opt-out insurance through superannuation. The 10 claims above are a great example of what we do, and why we do it. There are many other Australians just like them. Each and every day, our claims assessors make a difference to everyday Australians insured with AIA Australia through their superannuation.

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<sup>6</sup> AIA Australia – Life Today study – published 2016

## Part 2

Part 1 gave an insight into the tangible benefits that life insurance provides through superannuation.

Part 2 of this submission has been prepared to give further clarity and context to the benefits of insurance within superannuation, while identifying several areas in which the industry is encouraged to consider as potential areas of enhancement.

Funding insurance premiums within superannuation is an important mechanism through which millions of Australians are provided cover. The default opt-out system helps deliver a safety net to those who may not have considered taking out cover, and those who may not have been able to do so individually. This safety net is important, not just to individuals, but affords Australia with a significant social and economic benefit. Therefore it is crucial that the cover provided is continually reviewed and improved to ensure that it is provided at a cost that does not unduly detract from retirement incomes, and remains sustainable for the industry to continue to deliver the positive outcomes - referenced in Part 1.

AIA Australia considers that the key benefits of life insurance through superannuation are demonstrated by:

- Economic and social factors;
- High payout rates across the industry;
- Benefit design that provides a strong safety net with flexibility to suit members' needs;
- Providing access to cover where it may otherwise not be possible or affordable;
- Providing cover where individuals would not otherwise have cover in place; and
- Providing individuals with support beyond financial benefits.

AIA Australia considers the following areas remain an opportunity for continual enhancements by the industry:

- Low member awareness and understanding;
- Meeting members' needs; and
- Simplification and standardisation.

A clear understanding of the strengths, and opportunities for enhancement, for life insurance within superannuation is an important step in correctly framing the objectives, criteria and indicators of the Productivity Commission report. This will ensure it can deliver results that will improve efficiency, competition and outcomes for members without detracting from the existing benefits.

### **Benefits of life insurance within superannuation**

#### **Economic and social benefit**

The default opt-out system transfers the financial risk related to premature death and unexpected disability from the public to the private sector. According to Rice Warner, coverage for Death across all Australians exceeds \$4.1 trillion, and coverage for Total and Permanent Disability exceeds \$2.7 trillion.<sup>7</sup> The majority of this coverage is provided through group arrangements automatically, without evidence of good health, provided the member is at work. This includes the ability for members to vary their cover or opt-out to suit their needs. Without these group arrangements many would forego cover, face premiums that were prohibitively high, or be uninsurable. This would result in individuals and social welfare schemes bearing the financial risk currently borne by the private insurance industry.

AIA Australia is always seeking to maximise the economic benefit of group insurance for its members. Research has shown that for every additional day that a member is on an income protection claim for an injury or illness, the cost to the industry is estimated to be a total of

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<sup>7</sup> Rice Warner – Underinsurance in Australia – published July 2015

\$219,000 per day, or \$80 million per year.<sup>8</sup> In 2015, AIA Australia tracked their investment in occupational rehabilitation and return to work programs, identifying that for every \$1 spent, a saving of \$70 was realised. We were able to pass this saving back to members through better premiums at renewal and improved services. These occupational rehabilitation services not only improve the mental well-being of our members, but enable them to continue saving for their retirement and thus reducing reliance on the Age Pension.

AIA Australia also contributes to the community through its AIA Vitality program. Over the past three years, AIA Australia, has invested heavily in this program which encourages and rewards its members for being active and living a healthy lifestyle. This again demonstrates our commitment, and that of other insurers, to engage in alternative initiatives that benefit the community more broadly and enhance the relevance and sustainability of the life insurance industry moving forward.

Furthermore, AIA Australia is a keen supporter of SuperFriend, which is a collaboration between profit-to-member superannuation funds, group life insurers and the mental health sector that aims to improve workplace mental health and implement wellbeing initiatives.

The combination of paying benefits, and associated 'return to work' and occupational rehabilitation programs, allows insurance offered within superannuation to play a critical role in supporting members in their time of need. This helps to mitigate the significant flow-on social and economic impacts of individuals being out of work long term, resulting in social and economic benefits passed on not only to those individuals, but more broadly onto the Australian economy and community.

### **High payout rates across the industry**

More than \$4.38 billion was paid to superannuation members by insurers in the 12 months to 30 June 2015.<sup>9</sup> In 2015 more than 90% of group insurance claims were accepted by AIA Australia –almost \$850 million to over 10,000 claimants. While a significantly high proportion of claims are paid to members of group insurance, the relative margins earned by group insurers is relatively low compared to retail and direct channels.<sup>10</sup> This demonstrates the value that members receive for the payment of premiums through their superannuation. Accordingly, any changes to coverage, definitions, how insurance inside superannuation functions, or changes that would result in significant disruption to risk pools, should be carefully considered to enable stable and sustainable outcomes.

These figures highlight the value of insurance within superannuation to fund members, with more work required to help improve member engagement and awareness levels of members that would likely result in an even greater value to be realised.

### **Benefit design that provides a strong safety net with the flexibility to tailor to suit members' needs**

Funds are focused on ensuring that insurance provided within superannuation is meeting members' needs. The insurance offered to their members forms an important part of their value proposition, meaning that they must select insurance benefits that will attract and retain members.

The focus on members' needs is reinforced through legislative and regulatory initiatives including Superannuation Prudential Standards, and the funds' Insurance Management Framework and Insurance Strategy that was developed as part of the Stronger Super reforms.

The result is that funds are increasingly taking into consideration member demographics when developing benefit designs with an aim to put in place the right levels of default cover to meet the needs of members. Further, trustees that apply for a MySuper licence are required to

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<sup>8</sup> APRA Half Yearly Life Insurance Bulletin - issued 12 June 2013

<sup>9</sup> APRA Annual Superannuation Bulletin June 2015

<sup>10</sup> APRA Quarterly Life Insurance Performance Statistics Report for June 2016



demonstrate to APRA how member demographics help shape default Death and Total and Permanent Disability benefits of their MySuper product(s).

Funds continue to better target their benefit design with regard to ongoing member feedback. More and more funds have undertaken consumer testing and research to this end. For example, Sunsuper and AIA Australia have conducted extensive consumer research and testing to ensure that benefits evolve to better suit member needs. This consumer research involved contacting over 300 Sunsuper members who had previously been paid a Total and Permanent Disability benefit – identifying that within 3 years of the claim, 22% had returned to work and a further 14% were actively seeking employment. Members overwhelmingly wanted assistance beyond just the financial benefit with two in three wanting assistance in finding a job and seven in 10 wanting assistance in retraining and up-skilling. These insights formed the basis of the development of the Sunsuper's TPD Assist benefit which launched in July 2016.

Given awareness and engagement remains an area for opportunity, many members remain on default cover. Therefore, a thorough process for determining the appropriate level of default cover is a critical component in providing insurance. However, circumstances of individuals may differ from a fund's standard demographic and default cover which may not necessarily be sufficient to meet their needs. As such, funds and insurers have increasingly leveraged self-service technology such as needs calculators, quotation tools and online applications, together with simplified processes to enable members to vary their cover, or opt-out should the default benefit design not sufficiently meet their specific needs.

### **Providing cover where individuals would not otherwise have cover in place**

The evolution of group insurance over the past 20 years has seen up to 92% of the working population afforded some type of insurance coverage that would otherwise not be in place.<sup>11</sup> AIA Australia recently conducted research with outcomes indicating that almost one in two of those with life insurance in superannuation believed they would not be covered if it was not provided automatically.<sup>12</sup> Without default cover offered on an opt-out basis, a potential gap of almost \$2.2 billion would be created. The alternative for these individuals is to rely on social security and other welfare benefits, creating a further drain on an already challenged Federal Budget. This is an example of allocative efficiency. Affordable access to insurance protects every day Australians from the economic risks of injury, illness or disability and enables them to continue to save for retirement.

### **Providing access to cover where it may otherwise not be possible or affordable**

Superannuation is an effective means to provide affordable insurance cover, regardless of personal circumstances. This is because group insurance is based on a pooling of lives that, in the absence of individual medical underwriting, includes a selection of both good and bad risks. This may allow members who have pre-existing medical conditions that otherwise don't prevent them from working, are working part-time, or are working in high risk occupations to access insurance cover that is affordable, especially when compared with the restrictions, exclusions, or premium loadings that are likely to apply if they were to be underwritten for individual cover.

### **Providing individuals support through their claim beyond simply financial benefits**

Superannuation funds together with insurers have increasingly extended the support services offered to members through occupational rehabilitation and return to work support. In part, this has been delivered by life insurer claims assessors themselves, many of whom have allied health experience. This is a reflection of the focus on the member's ability rather than their disability and the desire of all parties involved - the member, the employer, the superannuation fund and the insurer - to see them return to work in some capacity where possible. Assisting a member to return to work in some capacity gives the member a sense of purpose, and also ensures they can continue to save for their retirement. This further reduces the drain on the public purse. Insurers have extended their services to look at preventative measures such as

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<sup>11</sup> Rice Warner – Underinsurance in Australia – published July 2015

<sup>12</sup> AIA Australia - Life Today study – published 2016

AIA Vitality, focusing on the health and wellness of members to help them avoid or minimise the impact of preventable illness and injury. This includes investment in stay at work and absence management programs.

In considering whether the insurance cover offered to members meets their needs at least cost, a broader definition of insurance should be considered, beyond simply the financial benefit paid to members. The value that insurers invest in occupational rehabilitation, return to work support and in preventative measures should be part of the measures adopted to support the objective of providing cover that meets members' needs at least cost.

## **Opportunities for enhancement**

While AIA Australia recognises the significant social and economic benefits that group insurance affords many Australians, we are cognisant that there are areas that can be further enhanced to ensure that members receive the most value from this protection, without unnecessarily eroding their retirement savings.

### **Low member awareness and understanding**

Member awareness of life insurance has improved over the past decade - largely driven by super funds giving more attention to communicating the benefits of their insurance offering. In line with the Stronger Super reforms, there has been increased competition between funds and differentiation on the basis of insurance. This has also increased awareness, best demonstrated by the spike in claims volumes from 2012 which can be partly attributed to this.

Life insurance has long been considered inherently difficult for consumers to value and understand. For many people, insuring their income seems much less tangible than insuring a physical asset such as their car or home. For others, the nature of life insurance can be quite confronting and unpleasant to consider. As a result, many would rather avoid considering the risk altogether, let alone taking active steps to insure against it.

This means that there remains a significant awareness issue for many members, particularly at an earlier age where engagement with insurance and superannuation is generally low. In many instances this is where insurance is most important, because it is protecting income over a lifetime. The nature of default cover means that members will always be able to improve their insurance cover to better meet their needs. The best way for a member to do this is by seeking advice. This emphasises the importance of the initial communication with members when cover first commences. Initial engagement can drive consumers to tailor their cover, including considering whether it is appropriate to opt-out.

What we do know is that those who do suffer an unexpected event value the cover they have in place. Recent research conducted by AIA Australia reported that 74% of those with life insurance in their superannuation see its inclusion as a real positive.<sup>13</sup>

One way to improve awareness and understanding of life insurance through superannuation could be through a simple and standardised annual member statement disclosing relevant insurance details. This could be initiated at little cost by leveraging the existing members' superannuation statement. The annual statement could also include information on how to vary cover, or how to opt-out of cover should a member feel that it does not currently meet their needs. This is also a positive step to help address concerns relating to over-insurance, duplicate cover, and ensuring that products continue to meet needs.

As part of this standardised insurance disclosure, a simple benchmark cost could also be included to assist members in understanding how insurance through superannuation compares with other insurance covers they may have. For example some trustees compare the premiums with the average annual cost of comprehensive car insurance. This would help members readily identify and better appreciate the value of their cover.

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<sup>13</sup> AIA Australia - Life Today study – published 2016

The emergence of digital advice platforms may also prove a useful tool in educating members about life insurance through superannuation and encourage them to further consider their insurance needs.

Some of these initiatives are already undertaken by trustees however we considered that there are opportunities for life insurers to work more closely with fund trustees to improve awareness and deliver better outcomes for all.

### **Meeting members needs**

Funds are increasingly diverging and differentiating their benefit designs to suit the needs of their member base. For example, Sunsuper have implemented an annual assessment Total and Permanent Disability benefit called TPD Assist, while others, including the Commonwealth Superannuation Corporation (CSC), are extending their benefit period from 2 years to 5 years on their default Income Protection and reducing Total and Permanent Disability cover levels to better align the disability benefits offered and fully utilise the return to work and occupational rehabilitation support that AIA Australia provides.

This divergence in benefit design is becoming more and more common in the market as funds and insurers use claims experience analysis to continually improve the type of benefits available, for example, where analysis identifies gaps in benefit design that permit benefits when it should not or denies benefits when they should be paid.

Members also have the ability to vary or opt-out of their default cover should they consider that it does not meet their needs. Though funds can use available data to improve their product design for their base demographic, increased member awareness remains vital to ensure that members consider their available options to tailor their cover to better suit their needs.

A continued focus on evolving the way in which group insurance can best meet members' needs is essential across the industry and must take into account the complex nature of group insurance and the differing demographics of risk pools.

### **Striking the balance**

The default insurance cover provided by most superannuation funds is unlikely to meet the specific needs of all members, although it aims to meet the needs of most members. In many cases, members will be underinsured relative to their true protection gap, evidenced by the persistent underinsurance gap that remains despite the widespread coverage afforded to most superannuation members through default arrangements. There is opportunity to consider what structural improvements can be made to ensure that members are adequately protected while also ensuring that they continue to save for retirement.

Most default insurance designs provide a safety net aimed at addressing minimum needs for most members. Funds pursue the best design based on demographics of their membership and any member research undertaken, balancing the cost and impact of eroding members balances. The risk of increasing default coverage inside super is the impact it has on the member's retirement savings.

Insurance needs can be considered to fall into two buckets:

- a minimum level of default cover to meet basic needs; and
- additional voluntary cover taken by members to meet specific needs.

Voluntary cover would be facilitated through their superannuation fund, and either funded through additional contributions to superannuation to take advantage of the concessional tax arrangements or alternatively paid by the member directly. To ensure that members did not utilise the tax advantages of the superannuation system to the detriment of their retirement savings, a level playing field should be created, allowing members to claim the cost of insurance premiums as a deduction against their personal income. These structural improvements could achieve the dual goals of ensuring members balances aren't eroded while ensuring that Australians are adequately protected.

## **Simplification and standardisation**

Despite the efforts of trustees and insurers to improve member understanding of their insurance cover, awareness remains low. The use of digital advice and enhanced annual statement reporting may address some awareness concerns, however the use of standardised definitions may prove instrumental in improving member understanding.

For example, 'any occupation' Total and Permanent Disability could be used as a default for MySuper cover, which would assist in simplifying product terms and improving member understanding of base coverage. To ensure that steps taken towards sustainability are not impeded and can continue, recent developments in definitions will need to be considered in any implementation of standardised definitions. For example, access to rehabilitation and/or retraining programs to be permitted up to the date of lodgement or assessment.

Though standardised definitions will allow members to more easily understand and engage with insurance within superannuation, flexibility must remain for trustees to tailor cover to their members' needs, such as payment of Total and Permanent Disability benefits through instalments. This flexibility is pivotal in protecting the community against underinsurance, which would undermine the public benefit of insurance within superannuation and transfer risk allocation from insurers back to individuals and the welfare system.

AIA Australia also recommends that the Superannuation Industry (Supervision) Act definition of permanent incapacity be reviewed and would ideally be aligned to any agreed standardised Total and Permanent Disability definition to remove any inconsistency between access to insured benefits and accumulated superannuation balances.

## Part 3

Parts 1 and 2 of this submission, outlined the benefits of insurance within superannuation to individuals.

Part 3 of this submission provides comments and alternatives suggested by AIA Australia regarding some of the Productivity Commission's proposed objectives, criteria and indicators that will be used to assess the efficiency and competitiveness of the superannuation system, and the role of life insurance within that system. AIA Australia believes that the objectives, criteria and indicators need to be crafted carefully in order to facilitate results that are meaningful, relevant, promote the best interests of members and do not negatively impact the important role of life insurance within the superannuation system.

### System Level Objective

The Productivity Commission draft report proposes a system level objective in relation to insurance:

*"The superannuation system provides insurance that meets members' needs at least cost."<sup>14</sup>*

AIA Australia believes that the proposed system level objective might be too narrow, and does not reflect the broader policy role of insurance within superannuation. For example, in their February 2016 submission to Treasury's Objective of Superannuation Discussion Paper, ASFA recommended the incorporation of an additional objective relating to insurance, to:

*"Protect members who suffer misfortune or personal tragedy."*

ASFA contended that this objective was an important addition because group insurance is crucial in alleviating underinsurance, and associated negative economic implications for individuals and their families who suffer misfortune or personal tragedy. Underinsurance also poses risks to public funds, as those lacking cover would likely turn to social security benefits such as disability payments.

Bearing ASFA's submission in mind, AIA Australia is concerned that the Productivity Commission's current system level objective does not adequately recognise the broader policy objectives of insurance within superannuation. The Stronger Super reforms required funds to offer default opt-out cover and were designed with these broader policy objectives in mind. Consequently, any substantive assessment or examination into the role of insurance within superannuation should consider these broader outcomes in order to deliver meaningful results.

AIA Australia propose that the system level objective be recast as follows:

*The superannuation system provides insurance that ~~meets members' needs~~ delivers value to the individual member and to the community by meeting member needs at least cost.*

This objective will foster the development of criteria and indicators that will result in a more holistic assessment of insurance within superannuation.

### Criterion - Do funds offer insurance products that meet members' needs?

Consistent with our commentary on the system level objective, AIA Australia considers this criterion should be expanded to ensure that subsequent indicators measure the broader social and economic benefits delivered via group insurance.

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<sup>14</sup> Productivity Commission Draft report; How to Assess the Competitiveness and Efficiencies of the Superannuation System; August 2016 p.69

This could be achieved by rewording the criterion as follows:

*Do funds offer insurance products that meet members' needs **and deliver valuable protection to the community?***

#### Indicator – Duplicate insurance policies by insurance type

Measuring the number of duplicate insurance policies by insurance type may prove difficult, as superannuation funds have no access to member information outside their own fund. There is also no data readily available with respect to insurance coverage for individuals with multiple superannuation accounts. In addition, the ability for insurers to aggregate data and identify those with multiple insurance policies is problematic as the membership data provided by super funds to insurers is often de-identified for privacy reasons unless it relates to a claim or an underwriting application.

It should be noted that some members have made a conscious choice to have multiple insurance policies that may result in a higher level of aggregate cover in response to an event. Challenges arise in being able to segment data according to those who have made a conscious choice to have multiple insurance policies, and those who have duplicate policies because they are not engaged.

AIA Australia is aware that there has been a year-on-year increase in the number of single superannuation account holders, indicating a reduction in unintentional duplicate insurance policies. AIA Australia believes that the regulatory changes implemented by the government, including myGov and changes to inactive superannuation thresholds, will continue to promote consolidation. However, the benefits of consolidation must be considered in conjunction with the risks that members lose insurance rights through this process. As specified in Parts 1 and 2 of this document, insurance within superannuation has broad social and economic benefits to individuals and the community. Therefore, we recommend that both duplicate policies, and a lack of cover, need to be measured in order to conduct a more comprehensive assessment.

Accordingly, AIA Australia recommends that the following additional indicators be included to better inform the criterion:

- Aggregate level of protection provided through group insurance arrangements in superannuation (level/value and number of members covered); and
- Private and public costs of underinsurance arising from reduced levels of group insurance coverage.

#### Indicator – Rates of insurance take up in choice products and SMSFs relative to default products

AIA Australia encourages the Productivity Commission to provide further clarity as to what it hopes to learn from this indicator and how it informs an assessment of insurance products meeting member needs.

We recommend that more effective indicators might include:

- Ratio of members increasing default cover or opting out of default cover; and
- Ratio of members using 'needs calculators' and/or 'quote tools' for those who otherwise do not vary cover.

These indicators would better investigate member opinions of their default insurance without seeking to compare very different subsets of members for whom insurance offerings are designed very differently. The ratios proposed would provide a better indication of satisfaction with default levels of insurance.

#### Indicator – member awareness of key features of their superannuation, including insurance

As a default product, members are not likely to be fully across the full features and benefits of their insurance within superannuation.

To determine if insurance is meeting members' needs, AIA Australia believes this indicator should be supplemented with qualitative research that measures the attitudes of members when they are made aware of their insurance through superannuation. Insurance may sufficiently meet member needs even if they are not aware of it. AIA Australia encourages the Productivity Commission to consider member attitudes, and whether members would have taken out cover otherwise.

To that end, AIA Australia propose the following additional indicators:

- The ratio of members with insurance coverage through risk pooling/group underwriting compared to choice only;
- The value of non-financial benefits, such as return to work programs, delivered through group insurance in superannuation;
- The degree of education and advice provided by super fund trustees in relation to insurance in super; and
- Member attitudes toward insurance within superannuation when they are made aware of it.

#### Indicator – level of unclaimed insurance

The level of unclaimed insurance would be quite difficult to measure, however AIA Australia imagines it to be quite low given the advice provided to members by their general practitioners, financial and legal advisers and superannuation funds. Trustee obligations to pursue legitimate claims indicates that the level of unclaimed insurance would be relatively low.

This indicator is challenging from a data perspective because it would require segmentation of those who did not pursue a claim because they were unaware of, or did not fully understand, their insurance, and those who chose not to claim because of worker's compensation or enterprise bargaining agreement protections.

AIA Australia recommends that the following indicators will provide better insight into the awareness and resources available to members:

- Ease of access to information on how to make a claim;
- The degree of education and advice provided by superannuation fund trustees in relation to insurance in super; and
- Actions undertaken by funds, insurers, employers and others to make claimants aware of their cover.

#### Indicator – ease of members opting out of insurance

Members are able to opt-out by contacting their superannuation fund via multiple channels, including online, via telephone or by completing paper forms.

AIA Australia considers that better insight could be gained by adopting a broader indicator to the above such as:

- Ease of members amending insurance arrangements in superannuation

#### Indicator – time to respond to members compared to retail provider benchmarks

AIA Australia encourages the Productivity Commission to exercise great caution when drawing conclusions from this indicator. Group insurance and retail insurance are quite distinct product offerings with unique characteristics that are likely to impact the time taken to respond to an insured.

For example, trustee review processes that are designed to protect the best interests of members may result in increased time frames for responses.

Accordingly, AIA Australia believes it would be more appropriate to assess performance with reference to superannuation industry benchmarks and service level agreements in place between insurers and funds.

We would recommend that this indicator be replaced as follows:

- Service levels, including response timeframes, meet the terms of APRA Prudential Standard SPS 250: Insurance in Superannuation.

Indicator – information collection by funds on key member characteristics and use of member information by funds to target insurance products

The Productivity Commission should note that funds typically have limited access to demographic information of members, for example, age, gender, location, employer, and salary.

While information such as marital status, dependants and debt may prove useful, this detail is not necessarily available to funds on commencement.

Therefore, assessment should focus on how the Insurance Management Framework and Insurance Strategy of funds incorporates the use of available data to enable insurance products and benefits to be tailored to member needs.

Indicator – Comparability of insurance product information disclosed by funds

Comparability is important so that members can decide which insurance cover will best suit their needs. AIA Australia believes that comparability at a high level is of most utility to consumers because it allows them to make an informed decision on whether the cover is right for them and whether it presents value for money.

Comparability with respect to granular detail, such as cover definitions, is more likely to lead to confusion and be less useful to consumers.

**Criterion – Are the costs of insurance being minimised given the type and level of cover?**

Consistent with our commentary on the system level objective and previous criterion, AIA Australia recommends that this criterion be amended so that the resulting assessment is well-rounded. AIA Australia is concerned that focusing on minimising costs may lead to results that don't meet members' needs, fail to consider the public benefit of insurance within superannuation, and the risks inherent with underinsurance.

This could be achieved by rewording the criterion as follows:

- *Given the type and level of cover, are the costs of insurance being minimised?*

The recommended criterion is more appropriate because it facilitates an analysis that balances the competing concerns relating to insurance within superannuation. These might include: ensuring that the cost does not inappropriately erode the retirement balance of beneficiaries, and that premiums are at a level that is sustainable for the industry.

Indicator – Insurance premiums inside and outside of superannuation

As detailed in Part 2 of this submission, insurance within superannuation involves a pooling of lives that contains both good and bad risks. Default cover therefore provides a breadth of coverage, where for reasons such as occupation, health, pastimes, language, and socio-economic factors may have made it difficult to impossible to obtain cover. Group insurance is designed to cover a vast array of members and is designed to suit their best interests collectively.

These factors mean that there are inherent issues in intra-channel comparisons that must be considered when comparing premiums inside and outside of superannuation.



#### Indicator – Insurance expenses (incurred by funds)

AIA Australia encourages the Productivity Commission to clarify that this indicator is related to expenses incurred in administering insurance services provided to members, separately from premiums.

An assessment of administration expenses should consider both historical costs and projected future costs. For example, a fund may have invested in new systems or technology creating a short term increase in costs that will deliver reduced costs over time.

It should be noted that structure and service offerings differ greatly between funds. A measure of insurance expenses incurred by funds should consider that some funds have negotiated their contracts so that insurers are responsible for administrative expenses on behalf of the trustees. These expenses should be considered as part of this indicator.

#### Indicator – erosion of member balances due to insurance premiums

AIA Australia consider that this indicator should be enriched by a layer of qualitative analysis. Focusing on a quantitative assessment of the value by which the superannuation balance decreases may neglect consideration of the benefits that insurance provides.

Many members make claims against their insurance, so a measure of how many members claim and the value of these claims should be considered against the reduction in account balance.

For those who do not make a claim, their premiums have value in mitigating risk or providing a safety net – giving them a sense of assurance. This is more difficult to value than a benefit payout but cannot be neglected when analysing the extent to which member balances are reduced.

In light of this, AIA Australia would ask the Productivity Commission to consider additional indicators as follows:

- what insurance cover cessation provisions do funds have in place to protect member balances?
- how do funds test their affordability in their insurance management framework?

#### Indicator – ratio of claims to premium revenue (loss ratio) within superannuation over 5 and 10 year periods

There are some inherent issues with the use of loss ratios that should be addressed to ensure the viability of this indicator.

Proper consideration must be given to:

- the timing of premiums paid and claims incurred, recognising that many claims are not notified until many years after the incident. For example, a loss ratio for the premiums collected last year will be very unreliable relative to one for premiums collected 5 years ago;
- assumptions made for any claims which have been incurred but not yet reported (IBNR);
- the accuracy of these assumptions is impacted to how well developed the claim experience is (that is, what percentage of likely claims have been notified); and
- differences between cohorts of members and between funds.

The level and scope of this data and information may prove challenging to obtain and raises concerns as to accuracy. Further, assumptions can be varied to suit different outcomes meaning that some standardisation needs to be considered to render a comparable result.

The Productivity Commission could consider looking at APRA's profitability data across insurers and reinsurers for insight into the efficiency of cost versus benefit.