Default insurance in super

One size does not have to fit all

aia.com.au

HEALTHIER, LONGER, BETTER LIVES

Contents

Executive Summary

Group insurance in super is an important safety net for millions of Australians who may not otherwise take out or hold life insurance cover. Insurance in super is offered as a default, recognising that many won't choose to take out cover, in some cases because of behavioural biases, or may be limited from accessing cover, for example because of medical history, occupation or nature of their work. Insurance in super forms part of the broader 'life risk' ecosystem, together with financial advisers who play a valuable role in tailoring cover to suit individual needs and the direct channel servicing those who are more self directed.

Insurance in super delivers clear value to Australians with 84 cents in every dollar[1] collected in premiums paid back in claims to members. The pooling nature of group insurance and low barriers to entry for members, makes the system work. Importantly, it also delivers shared value – to the economy, to the broader community, to their employers and to the members and their families.

Offering default insurance in super on an opt-out basis is the right policy setting. Rice Warner reported more than 90% of working Australians have some form of life insurance – with most of this provided through default opt-out arrangements. Financial advisers play an important role helping members understand their protection needs, but most Australians are unlikely to seek out or unable to pay for advice. Without the use of defaults, many Australians would remain uninsured.

Historically default cover has been designed to suit the 'average' member with variations in default cover based on age or salary. In reality, the average member is only representative of a minority cohort of the overall membership. One size does not fit all.

With the wave of regulatory scrutiny, the value and appropriateness of opt-out insurance in super has been questioned. Some have questioned the role of insurance in super altogether and the place for opt-out insurance in super may be considered as part of the Government's review of the retirement income system. The Hayne Royal Commission report recommended investigation of universal terms and standardised levels of cover for MySuper products. Regardless of whether the industry agrees with these proposals, the resounding message is that change is needed. The status quo is no longer appropriate.

Reinforcing this is what consumers have told us. They want to be notified and informed if there is insurance cover which may be more appropriate for them, but to give them the help and tools to make their own decision.

We remain firm in the view that default insurance in super is the right policy setting to provide a financial safety-net to millions of Australians and their beneficiaries whose working life is cut short or interrupted due to illness or injury. However, a default 'opt-out' system places a responsibility on the industry to ensure the system is optimised.

In this paper we present three concepts to better target default insurance cover that will deliver better outcomes for a wider cross-section of the membership, not just the notional 'average' member.

- MyNeeds – a cohort based default design option
- SmartCover – tailored to the individual using salary
- FlexiCover – using direct and indirect customer data

Ensuring default cover is a better fit for purpose across a broader membership which flexes with a member's circumstances, will drive greater relevance for members and increase the value of the 'protection' offered to those covered.

1. APRA Life insurance claims and disputes statistics issued 27 June 2019.

Current system

Super funds are required to provide death and permanent incapacity benefits to MySuper members on an opt-out basis but in doing so they must consider the cost so it does not inappropriately erode the members' super savings.

Because of the default nature of insurance in super, millions of Australians have been provided with insurance protection they likely would not have taken out otherwise. Default insurance in super is also relatively low cost compared to other channels, reflecting lower acquisition costs. It is also one of the most efficient life insurance ecosystems globally, returning 84 cents in every premium dollar to claimants.

For the most part, group insurance does not discriminate and is offered to all regardless of occupation or nature of employment. This provides a valuable safety net for those who are otherwise unable to access cover due to barriers such as access to low cost advice or personal circumstances limiting their ability to obtain cover like medical history, occupation or nature of work.

Benefit design evolution

Insurance in super started with a simple design, basic features and relatively low levels of cover designed to replace the savings otherwise foregone due to early death or retirement from the workforce. Continuation of benefits were linked to the ongoing receipt of contributions. Over time, this evolved into more of a needs-based design with higher levels of cover and richer features with continuation of cover linked to account balance.

Historically, industry funds provided super and insurance benefits for relatively narrow industry cohorts. Because many fund members worked in the same or related industry it was reasonable to believe the majority of members had similar insurance requirements in the absence or information, like debt and dependants or other forms of insurance. This led to one benefit design for all members at a fund or sub-fund level with age and salary being the main proxies for variation in cover.

Over time, many industry funds opened their membership to a broader group of members, employers and industries, diluting the original membership base. Equally, master trust sub-plans are no longer reserved for corporate offerings with a higher proportion of white-collar workers. With increased fund mergers and acquisition activity, there will be less homogenisation of memberships in the future. This diversity helps with better 'pooling' of risks across the membership.

Figure 1: Evolution of insurance in superannuation

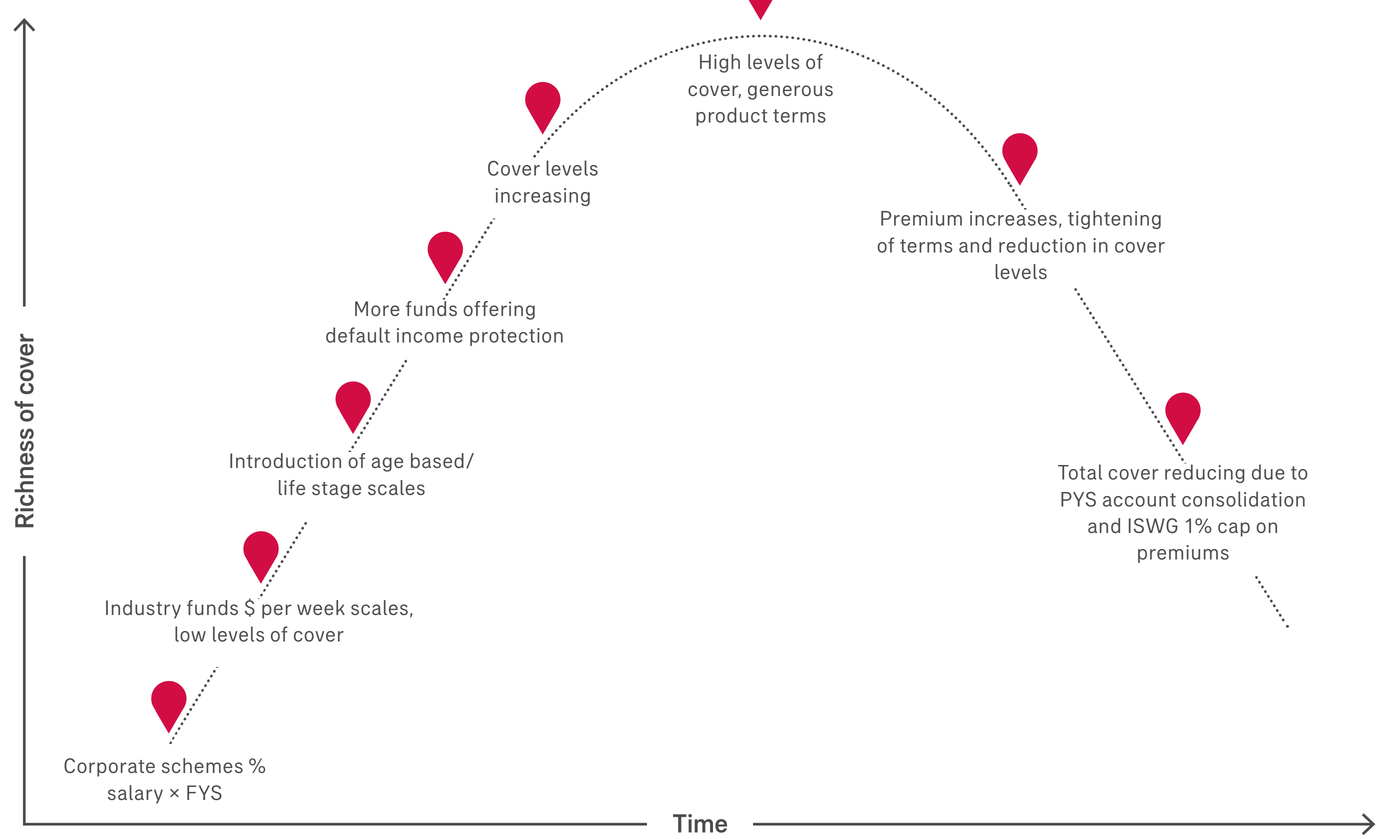


Figure 2: Typical default benefit designs

$1 per week scale

- Unit based cover
- $1 per week per unit
- Value of unit changes with age

Life stages scale

- Unit based cover or fixed cover based on age
- Cover amounts vary based on age

Salary

- Salary based
- Multiple of salary
- % salary × years of future service to age *n*

Member engagement

In comparison with other financial service products, engagement with life insurance in super is low, this is in part driven by [behavioural biases](). The default nature of the system means consumers don't need to engage and the abstract nature of retirement is hard for many to visualise as relevant to them.

Typically, members can be categorised into three main segments:

These members are unlikely to engage with super for many reasons.

The default design needs to provide a reasonable fit for these members without the unnecessary erosion of their super balance.

These members know they should do something but are unsure how to do it.

Recommendations and guidance will help to overcome behavioural biases as will making it easy and simple to action their choices.

These members know what they need to do, and just need to be directed to the appropriate channel to make the changes.

For them, the default design is a starting point and they will tailor cover to suit their needs and will respond favourably to being alerted to appropriate triggers to review their circumstances.

When it comes to insurance in super, recent research suggests most Australians would fall into the disengaged category. One in five (19%) members (the 'actively engaged') said they made changes to their cover, while one in five (20%) investigated making changes to cover but hadn't done it yet[1] ('interested'). For those who did change their cover, almost one in two recognised the default didn't suit their situation.

Within the current insurance in super system, there are plenty of options for a member to tailor cover to suit their individual needs, through underwriting, dial ups on joining the fund and the ability to increase cover at common life and age events. But tailoring of cover relies on the individual member taking action. Usually it is only the highly engaged members who will take this step.

For this reason, it is important the default benefit design is not static – it needs to provide a reasonable fit for 'disengaged' members and cater for the 'interested' members who are only likely to make a change if prompted.

1. AIA new insurance concepts in superannuation customer research, June 2019.

So, what's the problem?

Insurance in super on an opt-out basis has provided a good safety net for many Australians who would not have otherwise taken out any cover. Default settings can be improved to provide a more appropriate fit for a larger portion of the membership.

Default insurance benefits have usually been designed for the average member, but this means for most members, it isn't right for them. This is particularly the case where fund memberships have broadened and include members from various industries, ages and occupations.

Default levels of cover can be perceived by members particularly the 'Interested' segment, as already personalised for their circumstances, or endorsed by the trustee as being appropriate for them. This assumption reduces the motivation for the member to actively review their cover.

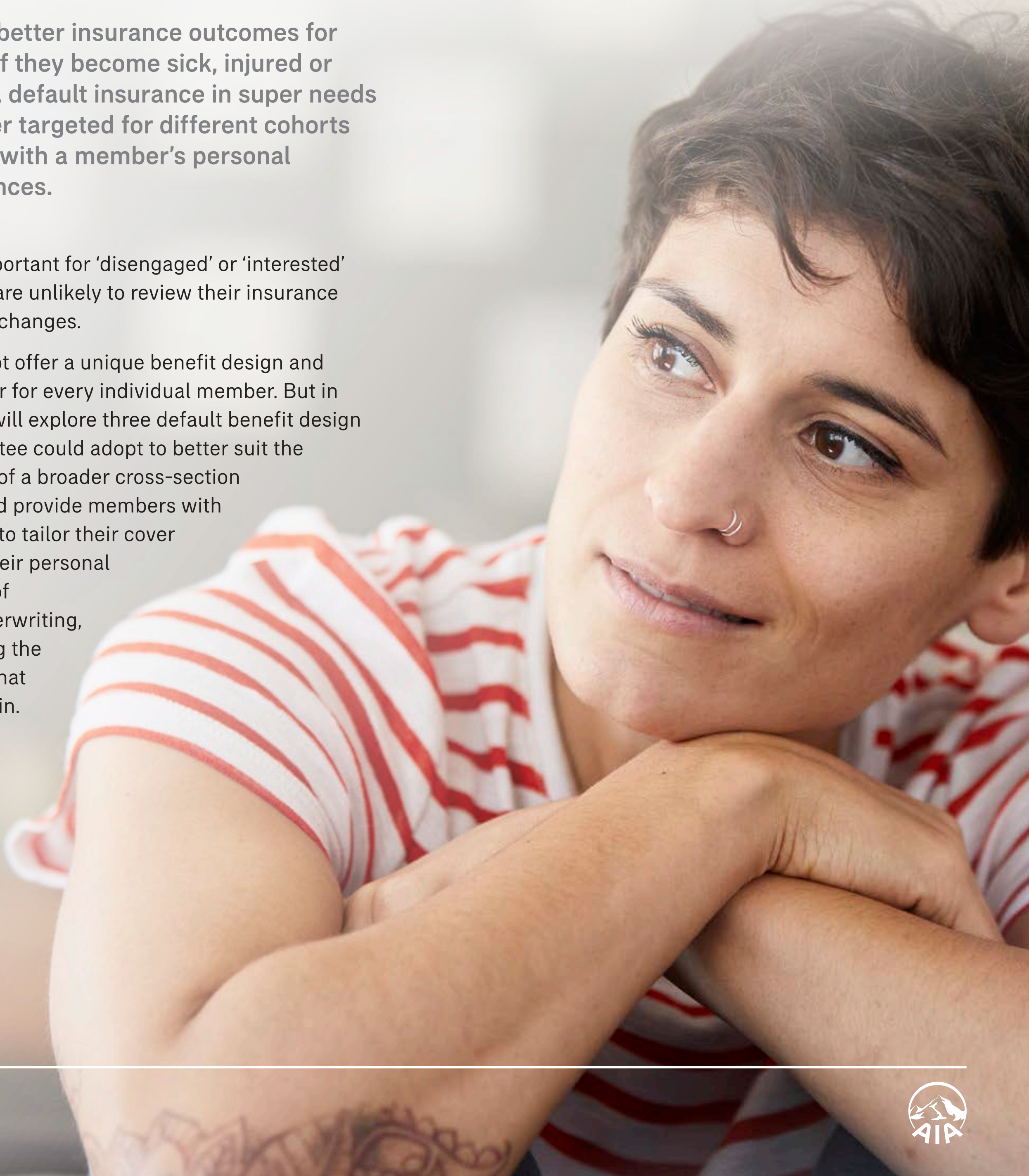
In the current regulatory environment, this best interests duty has become more prescriptive with trustees now required to undertake an annual assessment to review member outcomes and in doing so, consider outcomes for different cohorts of the membership, not just the membership as a whole[1]. This is in addition to ensuring a member's super balance is not unnecessarily eroded by insurance costs.

To deliver better insurance outcomes for members if they become sick, injured or pass away, default insurance in super needs to be better targeted for different cohorts and adapt with a member's personal circumstances. This is

To deliver better insurance outcomes for members if they become sick, injured or pass away, default insurance in super needs to be better targeted for different cohorts and adapt with a member's personal circumstances.

particularly important for 'disengaged' or 'interested' members who are unlikely to review their insurance needs or make changes.

A trustee cannot offer a unique benefit design and amount of cover for every individual member. But in this paper, we will explore three default benefit design concepts a trustee could adopt to better suit the circumstances of a broader cross-section of members and provide members with an opportunity to tailor their cover to better suit their personal needs outside of traditional underwriting, while mitigating the selection bias that exists with opt-in.



1. *Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation) Act 2019* (Cth).

Why does the current system need change?

The regulatory landscape has changed

Prudential Standard SPS 250 was introduced in 2013 requiring trustees to develop an Insurance Management Framework (IMF) to manage making insured benefits available to beneficiaries. The IMF requires trustees to develop and regularly review its insurance strategy. In addition, insurance covenants were introduced into the Super Industry (Supervision) Act 1993 (SIS Act) requiring trustees to, among other things, consider the kinds and levels of cover it would offer to members and to ensure the cost of insurance doesn't inappropriately erode retirement incomes.

Prior to the introduction of SPS 250, there was limited guidance for trustees in offering insurance benefits to members.

More recently, focus has turned to erosion of retirement savings and the balance between adequacy of cover, affordability and sustainability. In late 2016, the industry united to form the Insurance in Superannuation Working Group (ISWG) and developed the Insurance in Super Voluntary Code of Practice (ISWG Code). The ISWG Code seeks to address many issues in relation to benefit design, including applying a cap on premiums to not exceed 1% of a salary[1].

1. Clause 4.9 of the ISWG Code.

Together, trustees and insurers must continue to do more to understand membership demographics and ensure the insurance benefits offered are in the best interests of more than just the average member.

In conjunction with the work the industry has been doing, there have been numerous regulatory reports and inquiries into the industry which has identified gaps within the system. These include:

- multiple insurance covers eroding account balances
- complexity of the products and definitions
- concerns around claims handling and decline rates.

The pooled nature of default insurance in super has resulted in benefits that are valuable for members broadly, but can be poorly targeted and unnecessary for some cohorts of members. Historically, this is because super funds know little about members needs such as the existence of debt or dependants. This causes misalignment between the member's expectation of what they are covered for and what they are entitled to if they claim, particularly for the 'Disengaged' or 'Interested' member segments. An example is members who are over insured for Income Protection (IP) and unable to claim on the full amount.

Together, trustees and insurers must continue to do more to understand membership demographics and ensure the insurance benefits offered are in the best interests of more than just the average member.

2016

September – Senate commissioned Productivity Commission to launch inquiry into life insurance

October – ASIC released REP498 report into life insurance claims handling

2017

December – APRA released 'Strengthening Superannuation Member Outcomes' discussion paper

2018

March – Parliamentary Joint Committee released final report into the life insurance industry

May – Parliamentary budget introduced original Protecting Your Super Bill

December – Productivity Commission 'Superannuation: Assessing Efficiency and Competitiveness' report

2019

February – Royal Commission final report and recommendations

March – Treasury Consultation Paper relating to universal terms and fixed cover for MySuper products

April – APRA review of 2013 Superannuation Prudential Framework

April – Improving Accountability and Member Outcomes in Superannuation legislation effective

July – Protecting Your Superannuation legislation effective

September – *Putting Members' Interests First Bill

* PMIF bill commences 1 April 2020.

Consumer engagement is low but expectations have changed…or are they just more apparent?

Disengagement with super has been a longstanding issue for the industry, despite trustees investing in digital capabilities, educational tools and more personalised member communication. Through greater use of surveys, customer testing and social media, consumer expectations have become more apparent. Consumer research tells us mandatory super relates to benefits being reaped well into the future can drive disengagement as consumers don't feel they have a role in making decisions or choices. There is even less awareness of insurance in super.

ASFA and the FSC recently commissioned research showing[1]

- **23%** knew exactly what life insurance cover they have through their super
- **21%** know they have some life insurance through their super, but are unsure of the details of cover
- **33%** know they don't have life insurance cover
- **23%** are unsure of whether they have cover.

Traditionally, Australians worked in more permanent employment and stayed with the same employer for longer which neatly aligned with the super framework and regular contribution patterns. This meant a 'one size fits all' approach was a reasonable method and allowed most members to take a hands-off approach to managing their super and insurance.

But the environment has changed…

With the rise of the 'gig economy', arrival of the digital workplace and employers offering more flexible working arrangements, regular flow of super contributions have become less common. Workers in the 'gig economy' are generally not considered 'employees' and do not fall within the compulsory super framework. As the gig economy grows and more Australians work flexibly, this could result in less Australians contributing to super or holding insurance in super emphasising the importance of evolving with life's circumstances.

A global study by Accenture into consumer demands in banking showed consumers are expecting more personalisation[2]. In exchange for their data, they expect their financial services provider will send them information based on their personal circumstances or preferences, such as the best mortgage deals when buying a house[3]. Insurance in super is no different. Data is used by some to trigger to personalised insurance cover and proactively offer members the right bundle of cover to adapt to changing circumstances. This is being further enhanced by some through a strong digital offering making it easy for members to interact with the fund, update their details and circumstances, receive insurance offers and make changes to their cover.

Recent consumer testing has given us greater insight[4]. Our Life Today study sought to understand awareness of insurance in super and awareness and knowledge of cover levels, attitudes and opinions.

Consumers told us:

*" I am comfortable for my fund or insurer to **contact me about my life insurance requirements** if they become aware of a change in my circumstances "*

*" Give me **personalised cover** that is **right for me**. **Educate me** on what is the right cover and how it changes over time "*

*" **Minimise the options** and build clear and useful bundles of cover "*

Only three in 10 consumers who had insurance in their super said they were not comfortable or extremely uncomfortable with their insurance providers contacting them because of changing circumstances. This indicates a significant opportunity for the industry.

Trustees and insurers could use many data points to determine appropriate insurance cover, other than just age. This could include salary, dependents, savings, and interplay with other insurance such as health insurance or workers compensation. These are just some of the elements a trustee could consider in meeting the rising expectations of its members.

Members may still take a set and forget approach, but the expectation is their fund will tell them what they need and when, and help them manage this.

With expectations becoming more apparent, there is an obligation on trustees and insurers to ensure insurance benefits remain fit for purpose as a member's circumstances evolve.

1. This study was conducted on the YouGov Galaxy Online Omnibus between 22-24 May 2019.
2. Accenture Financial Services 2017 Global Distribution and Marketing Consumer Study: *Banking Report – Beyond Digital How Can Banks Meet Customer Demands.*
3. Ibid.
4. AIA Life Today Study, December 2016.

A member's relationship with super may last longer than their mortgage or marriage

There have been some significant recommendations to completely reshape the default super environment, such as the proposed top 10 'best in show' shortlist recommended by the Productivity Commission[1] and the stapling of a member to a single default account recommended by Commissioner Hayne in his Royal Commission report[2]. In addition, the introduction of the Protecting Your Super (PYS) package has reduced the number of duplicate accounts and insurance policies. While the future framework of default super is unclear, the concept of a member having only one or two funds over a lifetime could be a reality.

This construct could mean members hold the one super account from the time they enter the workforce to retirement – spanning 40 to 50 years. This is longer than the length of most mortgages and marriages. To the envy of other financial services, tenure of this length offers trustees an unrivalled opportunity to truly get to know and understand their members over the course of their lives.

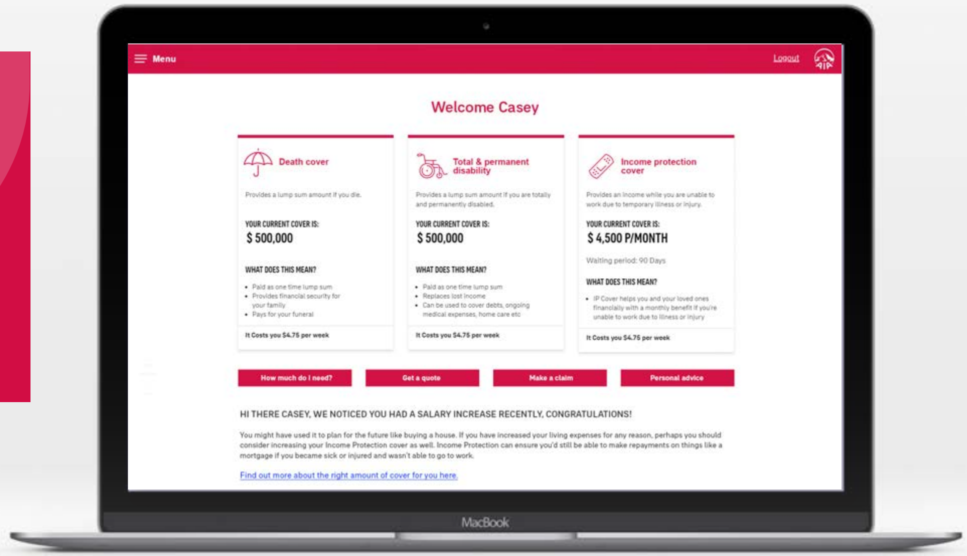
This presents a unique opportunity to flex insurance designs as a member moves through different life stages, other than just age and change the perception of life insurance to something that provides protection throughout their life. For example, if a member's first job is working in retail or hospitality, the type and level of insurance cover they need may be different if they later move into an unrelated industry. Equally, even if a member remains in the same industry throughout their working life, their insurance needs will change as their salary increases, they begin to have significant debt such as a mortgage and start a family. To meet the expectations of members, participants in the AIA Australia study indicated super and insurance needs to be made relatable to them and they need to be shown the consequences of inaction. This can help transition a 'disengaged' member to an 'interested' member and eventually to become 'highly engaged'.

*"Make insurance **relevant** and **relatable** for me"*

*"Make insurance **flexible** so that it **suits my lifestyle**"*

*"Tell me **when I need to change my cover**"*

*"Give me the basics – **tell me only what I need to know**"*



An AIA Australia study in shifting insurance in super from a low engagement product to a must have revealed these customer insights:

Consumers told us they want their insurance to be flexible so it can adapt with their lifestyle and they want to be told when their cover needs to change[3] Creating relevance to the life insurance they hold in super can build stronger affinity with their super at the age that it becomes more tangible.

There are opportunities to utilise this consumer willingness to share their data by contextualising their education and learning journey. Leveraging digital tools to deliver personalised pathways creates an opportunity to gather contextual information about a member that is relevant to better meeting their insurance needs. For example, clicking on an article about protecting dependants may indicate a member has a spouse or children. Contextualising the content by asking them about their marital status and how many children they have provides richer data and a greater personalisation of the experience.

1. Productivity Commission Inquiry Report No. 91, *Superannuation: Assessing Efficiency and Competitiveness, December 2018.*
2. Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, 1 February 2019
3. AIA Life Insurance Debrief research, November 2017.

The Future

While the best solution for aligning cover to needs and cost to affordability would be for all Australians to seek personal advice, this isn't possible today. A reasonable compromise may be for every individual in a fund to have the mix of cover that is appropriate for their individual needs while fitting within an affordability framework set by the trustee, like the 1% test (a cap on premiums to not exceed 1% of a salary). A member's cover would flex and adapt with the key moments in that member's life and their personal circumstances. This is an ambitious ask but there are ways for trustees to make changes in a staged approach to move in this direction.

We have developed three default design concepts which are better targeted at cohorts of members or individual members, to balance the wants of members and the responsibilities of trustees. These concepts are:

- **MyNeeds** – developing a different default benefit design for different cohorts of the membership
- **SmartCover** – using a member's SG contributions to infer salary and provide cover customised to the individual
- **FlexiCover** – using a combination of direct, indirect and external data points to customise the cover for an individual member's circumstances

The concepts will improve outcomes for more members, ensuring a more objective measure of whether cover is promoting the financial interest of members and to the level of engagement of members. The paper explains these concepts in more detail.

Concept 1
MyNeeds, a cohort-based default design option

An age-based scale to determine sum insured recognises the different needs and responsibilities experienced through a typical member's journey through life. But consumers said using age alone was arbitrary[1]. We believe it's important to take this further and develop the right bundles of cover for members who aren't like the typical member. Consumers told us they want cover to evolve with their key life stages and pivotal moments, rather than just with age. If a member's circumstances are different, they should have the flexibility to choose the cover that is right for them – without always needing to be underwritten and having to self-select their own cover levels and design.

Customers want guidance on what level of cover is appropriate for them, but also want to be given the choice whether to make this change, rather than it occurring automatically. A cohort-based design, which we have called MyNeeds, offers an immediate solution to introducing greater personalisation and relevance of cover to members.

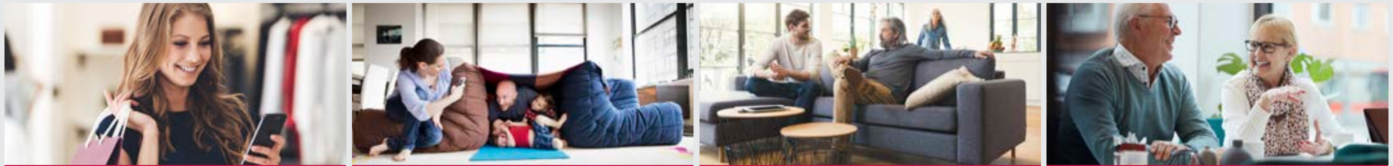
Figure 3 uses an age-based approach, but could be segmented by occupation, salary or employment status. Trustees are best placed to determine the most appropriate segmentation based on its unique membership.

1. AIA Life in Super research report 2018.

How does it work?

Upon joining the fund, the member is defaulted to the bundle of cover that applies based on their cohort. In the example below, this is driven by age bands. The member can also choose from a selection of other readymade bundles if they are not like the default member. This design recognises that not everyone is like the typical member but presents relatable alternatives. In addition, key assumptions in designing the bundles are more transparent, assisting member understanding and enabling choice.

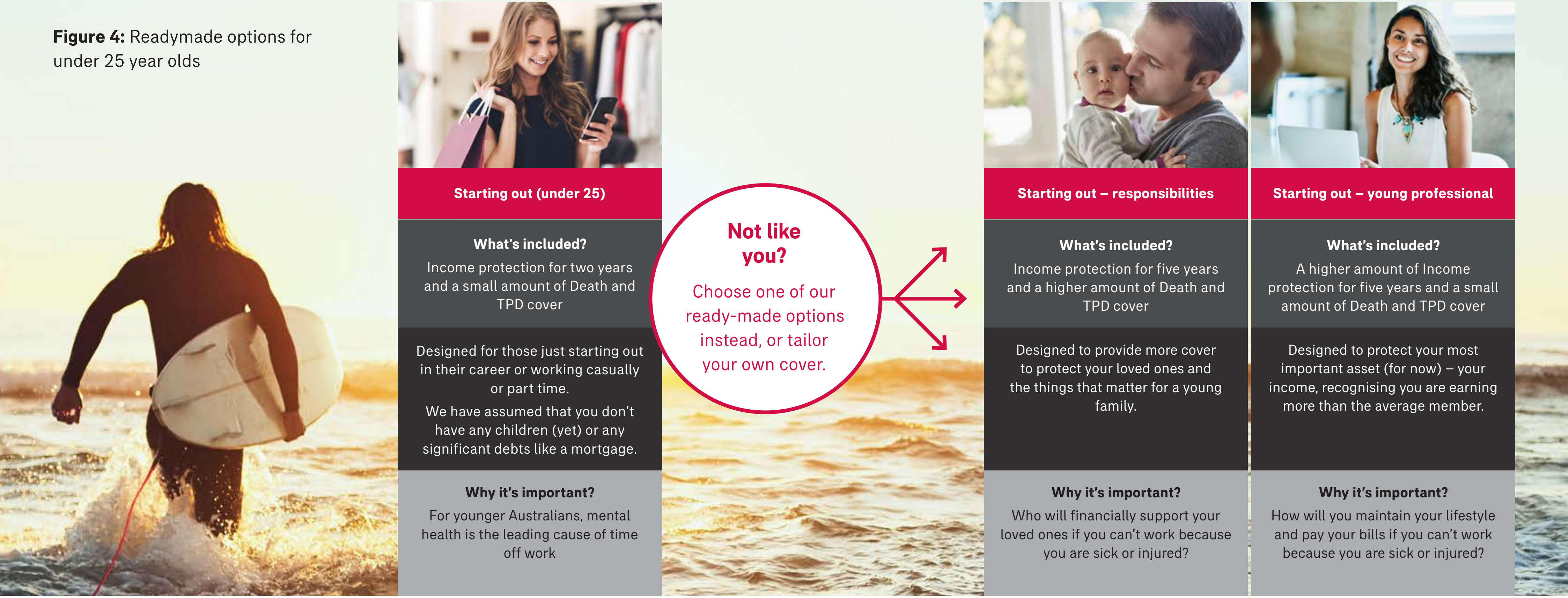
Figure 3: Default cover examples for cohorts based on age



Starting out (Under 25)	Asset accumulation/ dependents (age 25–40)	Debt reducing/dependents (age 41–55)	Winding down (55+)
What's included? Income protection for two years and a small amount of Death and TPD cover	**What's included?** Income protection for 10 years and higher amounts of Death and TPD cover	**What's included?** Income protection for five years and variable amounts of Death and TPD, reducing as you get older	**What's included?** Income protection for two years a small amount of TPD cover and a moderate amount of Death cover
Designed for those just starting out in their career or working casually or part time. We have assumed that you don't have any children (yet) or any significant debts like a mortgage.	Designed to provide more cover to protect your loved ones and the things that matter most for a young family. We have assumed that you are well into your career, working regularly, have a mortgage and you have a family and dependants.	Designed for those with older families focused on building some financial stability. We have assumed that your career is stable, your children are growing up and that you are making inroads paying off your mortgage.	Designed for those who are moving to retirement and towards the end of their career. We have assumed that you have nearly paid off your mortgage, your kids are in high school or are adults and your focus has become saving for retirement.
Why it's important? For younger Australians, **mental ill health** is the leading cause of time off work	**Why it's important?** During your working life, you have **more than a 60% chance** of being disabled due to illness or injury for more than one month	**Why it's important?** During your working life there is a **1 in 3 chance** of being off work because of illness or injury for six months or more	**Why it's important?** For men, a **1 in 2 chance** and for women a **1 in 3 chance** of being diagnosed with a cancer during your working life

Cover transitions automatically through the four life stages

Figure 4: Readymade options for under 25 year olds



MyNeeds recognises that not everyone is like the typical member the default cover was designed for. Each cohort is offered the default option and a choice of other readymade options. In the example below, this shows two readymade options, which provide choice and a simple decision without overwhelming the member but could be expanded to three of four other options without compromising decision inertia. The key is only presenting the options that are relevant to the individual member age cohort.

In the case of Jonathan, who has just joined his fund at 24, MyNeeds is presented to him as the default and two readymade options for under 25 year olds (Figure 4).

At regular intervals, including at major age milestones, Jonathan is presented with his current cover and alternative readymade options that might reflect his changing lifestyle and circumstance.

In designing the readymade bundles, it's critical that trustees and insurers are conscious of the cost. The may mean prioritising certain benefits over others to fund the appropriate trade-off.

Consumer testing

When we tested this concept with customers they liked this idea because of its clarity, tangibility and flexibility. Research showed that communicating the benefits and stepping them out individually helped people understand and feel secure about the cover.

Consumers felt they could easily assess which bundle of cover would suit them best and the concept of being able to pick and choose to suit their circumstances, was appealing.

> ***"It's much clearer, and it simplifies it a lot"***

Consumers have told us the concept of bundling is clear and makes sense to them[1]. Using relatable imagery and clearly explaining who the bundle of cover is designed for, helped customers easily identify which bundle would suit them best. The flexibility of this design lends itself to reducing cost of cover (whilst still providing appropriate protection) when members are young and building their balance and for members who are older and want to preserve their balance for retirement.

> ***"You can do what suits you at the time, and change it as needed"***
>
> ***"I think people will have more interest in it if they feel they can have some say and choice"***

1. AIA Life Insurance Debrief, November 2017.

One in two consumers told us they wanted to be prompted about changes in their circumstance that impact their cover as this would help them make decisions. The MyNeeds concept can be represented to members on a regular basis to ensure they have selected the right bundle or considered that the default cover is right for their situation.

Concept 2
SmartCover – tailored to the individual using salary

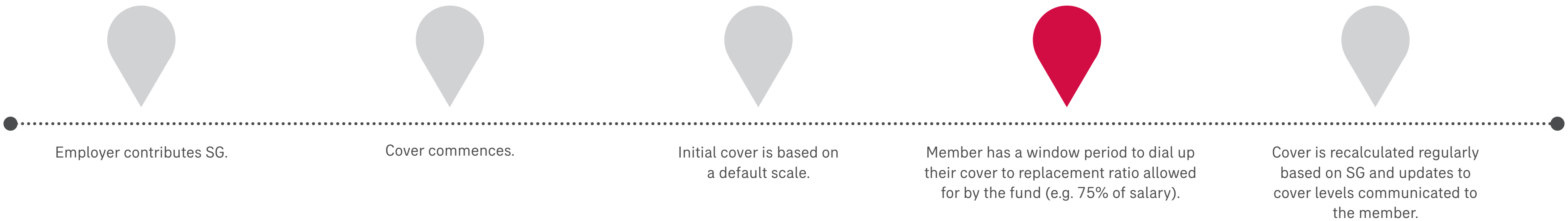
Building on the MyNeeds concept, which recognises not all members are like the typical member, SmartCover recognises that age should not be the only factor which determines appropriate default cover levels. Using contribution data, collected over a material period, to imply salary can better target affordability and balance erosion by linking cover levels to contribution amounts.

How it works

The SmartCover solution works best with a design that includes Income Protection, although it can be expanded to Death & TPD benefits too. Generally, income protection covers a member for up to 75% of their pre-disability income overlaid with an age-based scale and capped at an automatic acceptance limit. However, the benefit paid is usually designed for the typical members meaning many members may be over or under insured. This often creates confusion for a member in the event of claim and fails to offer the certainty of cover desired by members. Many funds do not actually receive salary data for its members, contributing to the issue.

The SmartCover design uses a member's SG contributions over an extended period (at least six months) to infer the member's salary which is then used to calculate the member's sum insured. Sum insured can be regularly recalculated to ensure it remains relative to the member's salary.

A significant benefit of SmartCover is the likely reduction in complaints about the amount of benefits paid, which represents up to 30% of all income protection complaints[1].



With the introduction of the Putting Members' Interests First Bill a member will take some time to build up an account balance to $6,000 providing a fund with some SG history before the member is eligible for cover. This may mean that a default scale is not required.

1. Analysis of AIA income protection complaints (2018 and 2019).

Consumer testing

A key consideration for trustees is whether the member's sum insured is changed automatically at each recalculation period, or whether the member is notified that a different sum insured may be more appropriate and allow the member to make that choice. Our customer research[1] found:

- **48%** wanted to be notified of a change in sum insured but allow them to choose to accept the change
- **21%** wanted cover to be changed automatically
- **8%** would not want cover to change.

Importantly, while most wanted to be notified, this didn't mean they wanted to have the option to choose it every time. Asking for permission once to automatically adjust cover still empowered members to make an active choice.

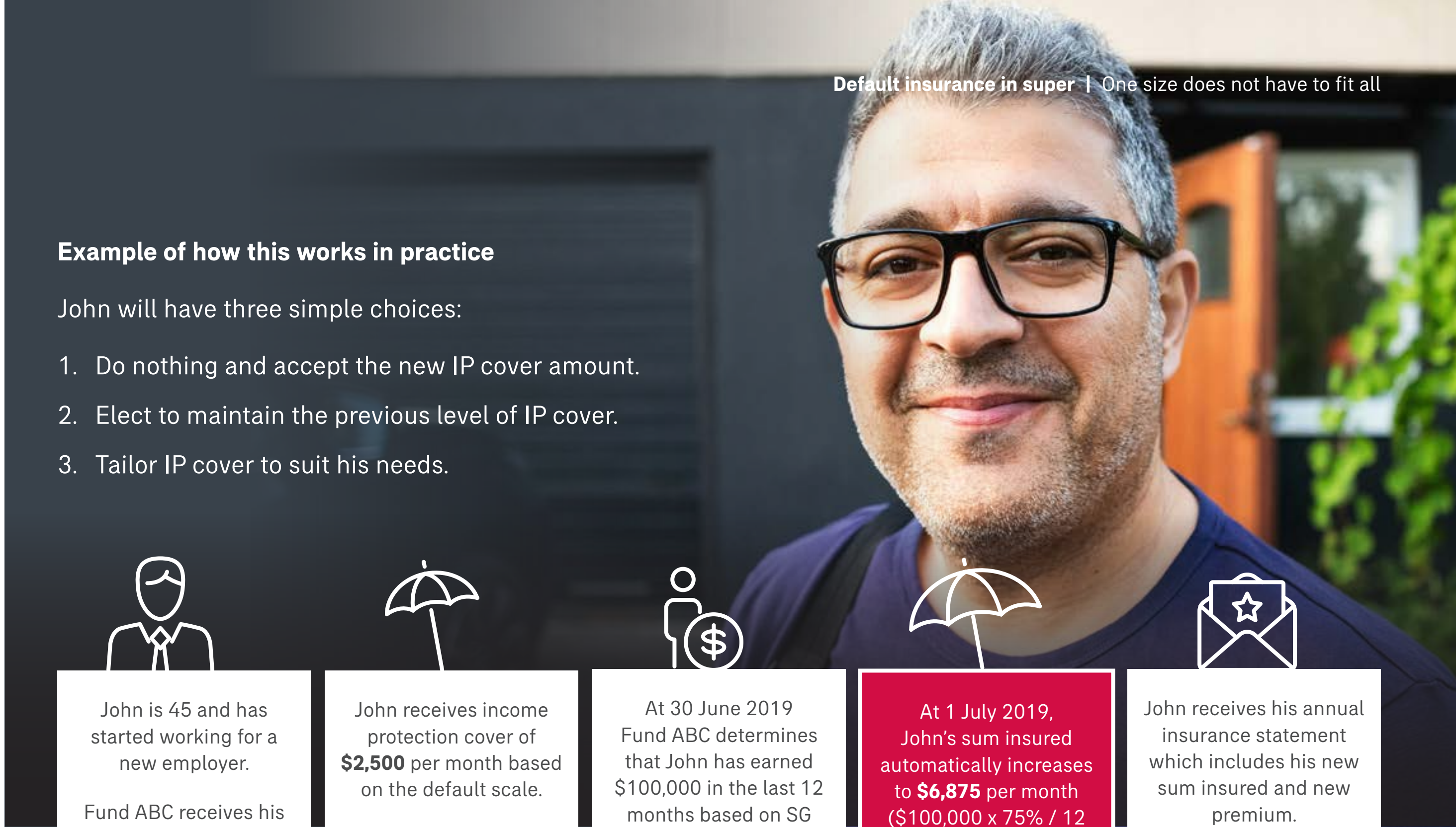
If a change to sum insured occurs automatically, in practice a fund could notify the member of the increase or decrease to sum insured based on their SG contribution patterns and offer the member three simple choices, as illustrated on the right.

Expanding the concept to death and TPD

Not all funds offer Income Protection as a default benefit. The same concept could be transferable to death and TPD cover based on the notion that consumption and need is broadly aligned with income. A member's salary (as inferred through SG contributions) could be the measure of affordable levels of death and TPD cover.

This approach can be used to infer a member's salary for the purpose of a % × salary × future years of service design.

1. AIA insurance concepts – findings and insights research, June 2019.



Example of how this works in practice

John will have three simple choices:

1. Do nothing and accept the new IP cover amount.
2. Elect to maintain the previous level of IP cover.
3. Tailor IP cover to suit his needs.

John is 45 and has started working for a new employer.

Fund ABC receives his first SG contribution on 1 July 2018.

John receives income protection cover of **$2,500** per month based on the default scale.

At 30 June 2019 Fund ABC determines that John has earned $100,000 in the last 12 months based on SG contributions received.

At 1 July 2019, John's sum insured automatically increases to **$6,875** per month ($100,000 x 75% / 12 months).

John receives his annual insurance statement which includes his new sum insured and new premium.

Typically this design has been reserved for corporate arrangements where a trustee can obtain a member's salary data. It's possible for a trustee to use the SmartCover design even where salary data is not currently captured.

Alternatively, rather than using a traditional age-based scale, a trustee could adopt a salary-based scale or even a blended age and salary-based scale to offer a greater degree of tailoring for a member's personal circumstances.

There are several other operational issues a trustee should consider such as the appropriate recalculation period, increases and decreases to cover, over insurance and premium affordability. Details of these considerations are in Appendix 1.

Concept 3
FlexiCover – using direct and indirect customer data

Super funds have the benefits of customer data collected over many years including where members work, where they live, their earnings, contributions, working patterns and even their predicted lifespan as reported by KPMG in its Super Funds and the Customer article[1]. This data combined with the potential of a default for life super framework can allow trustees to get to know members more intimately.

Extending the MyNeeds and SmartCover concepts further, FlexiCover is the culmination of direct data held by a fund, external data sources and utilisation of indirect customer data such as member interactions with the fund through call centres, changing preferences online or engaging with education modules offered by the fund and/or insurer.

Utopia would be to design benefits for a 'segment of one'. In reality, multiple cohorts can be identified, and cover tailored to suit those cohorts that better resemble the members circumstances compared to a default designed for the average member.

Existing data sources?

Super funds have the ability to collect a strong repository of member data such as age, location, employment status and earnings. Much of this data is available, but in some cases isn't being fully utilised to determine appropriate insurance designs for some cohorts.

Figure 5: Pathway to a segment of one

SuperStream

The implementation of SuperStream provides an important data source for trustees. SuperStream is the channel to transmit employee super guarantee contributions and data across the super system between employers, funds and the ATO. There are mandatory information fields under SuperStream which an employer must complete which contain basic information such as an employee's name, date of birth, address, TFN and period for which the contribution relates.

The introduction of standardised data under SuperStream has not improved the ability for trustees to obtain information that could be used to tailor insurance arrangements, as many of these fields are optional. Getting access to employment start and end dates, hours worked, occupation and employment status will assist with correct pricing and better targeting of cover levels and may help to trigger communication at relevant points, e.g. when cover should cease or where a member's benefit changes due to changes in their employment circumstances. As a starting point, trustees could enter into arrangements with their large employers to provide data for some of the optional fields.

This is an opportunity for industry to engage government and the ATO to work towards making these optional fields mandatory through SuperStream provided they can be robustly and accurately reported. Improving the granularity of information about a member's employment circumstances will ensure insurance benefits are better targeted. Details of the optional SuperStream fields and how they could be used are in Appendix 2.

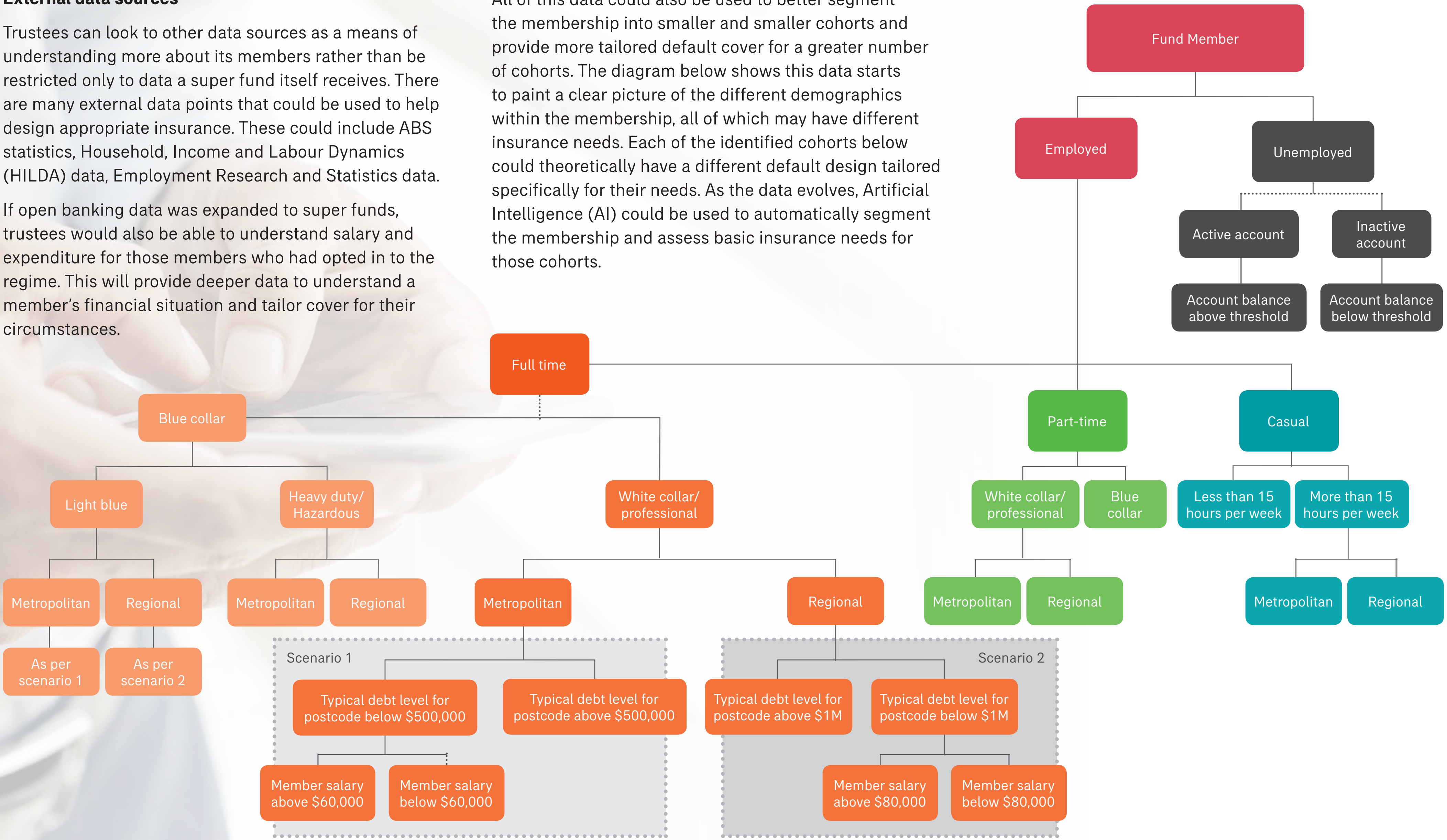
1. KPMG – *Super funds and the customer – striving for change*.

External data sources

Trustees can look to other data sources as a means of understanding more about its members rather than be restricted only to data a super fund itself receives. There are many external data points that could be used to help design appropriate insurance. These could include ABS statistics, Household, Income and Labour Dynamics (HILDA) data, Employment Research and Statistics data.

If open banking data was expanded to super funds, trustees would also be able to understand salary and expenditure for those members who had opted in to the regime. This will provide deeper data to understand a member's financial situation and tailor cover for their circumstances.

All of this data could also be used to better segment the membership into smaller and smaller cohorts and provide more tailored default cover for a greater number of cohorts. The diagram below shows this data starts to paint a clear picture of the different demographics within the membership, all of which may have different insurance needs. Each of the identified cohorts below could theoretically have a different default design tailored specifically for their needs. As the data evolves, Artificial Intelligence (AI) could be used to automatically segment the membership and assess basic insurance needs for those cohorts.



Collecting member data indirectly

AIA's customer research has shown key life events are often a prompt for members to think about their insurance needs. Typical life events that prompt changes in insurance needs include marriage, having children or significant career changes such as moving from full time to part time employment. Trustees don't have oversight of key moments in a member's life and is reliant on the member to notify the fund of these changes.

We see opportunity for funds to capitalise on its ordinary interactions with a member to learn more about that individual and consider whether this triggers a need for that individual to review and change their insurance cover. These micro-moments help to develop long term trust and loyal advocates among members.

There are key moments in a member's life which can indicate a need to review or change insurance needs. Together with key data points, these can indicate one of these events has occurred in a member's life and a trigger to contact a member about their insurance requirements.

In the short to medium term, this information could be used by funds to prompt members to review their insurance in light of their personal circumstances or change in these circumstances. As administration systems become more sophisticated and data evolves, this information could be used to place members in a default that is more appropriate for their cohort or to actually tailor the right mix of type and level of cover for the individual.

Figure 6: Member interactions which may impact insurance

Phone or chat interactions

During phone or click to chat interactions the member mentions their circumstances are changing (such as they are getting married, about to have a baby, changing jobs, buying a house)

Member initiated changes

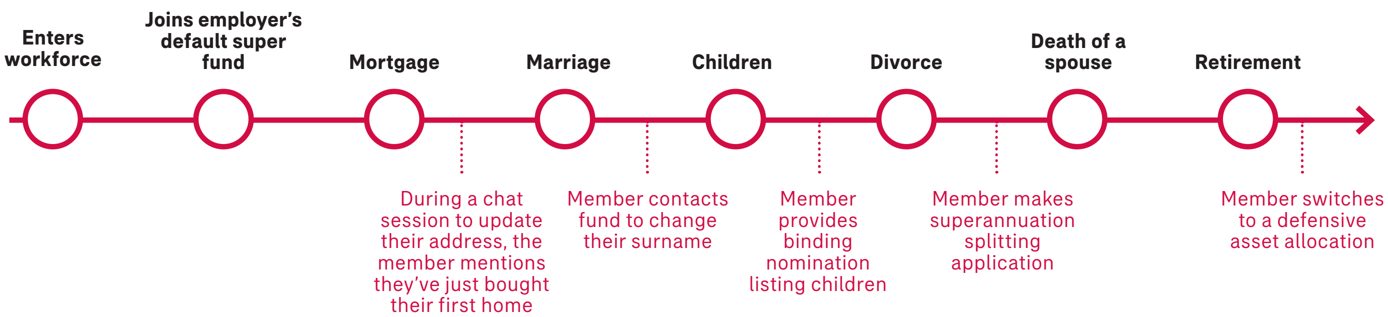
- A member may provide a binding nomination to the fund listing a spouse and or dependents. Number of dependants is a factor that can impact insurance needs
- Changing name with the fund could indicate the member has just been married or divorced

Education modules

Leveraging digital education and advice tools to deliver personalised pathways creates an opportunity to gather contextual information about a member that is relevant to better meeting their insurance needs.

- For example, clicking on an article about protecting dependants may indicate that a member has a spouse or children, contextualising the content by asking them about their marital status and how many children they have provides richer data.
- Fund notices that the salary entered into their retirement projections calculator suggest a salary that is higher than their current SG contributions, which could initiate a communication to review IP cover.

Figure 7: Micro-moments across a member's life stages



Helping members take action

Customer research clearly showed that while members want to be notified of what type and level of cover is appropriate for them, members want to make their own decision rather than it being changed automatically. Almost six in 10 (58%) consumers indicated they would be likely or very likely to switch their cover if a more appropriate option was available.

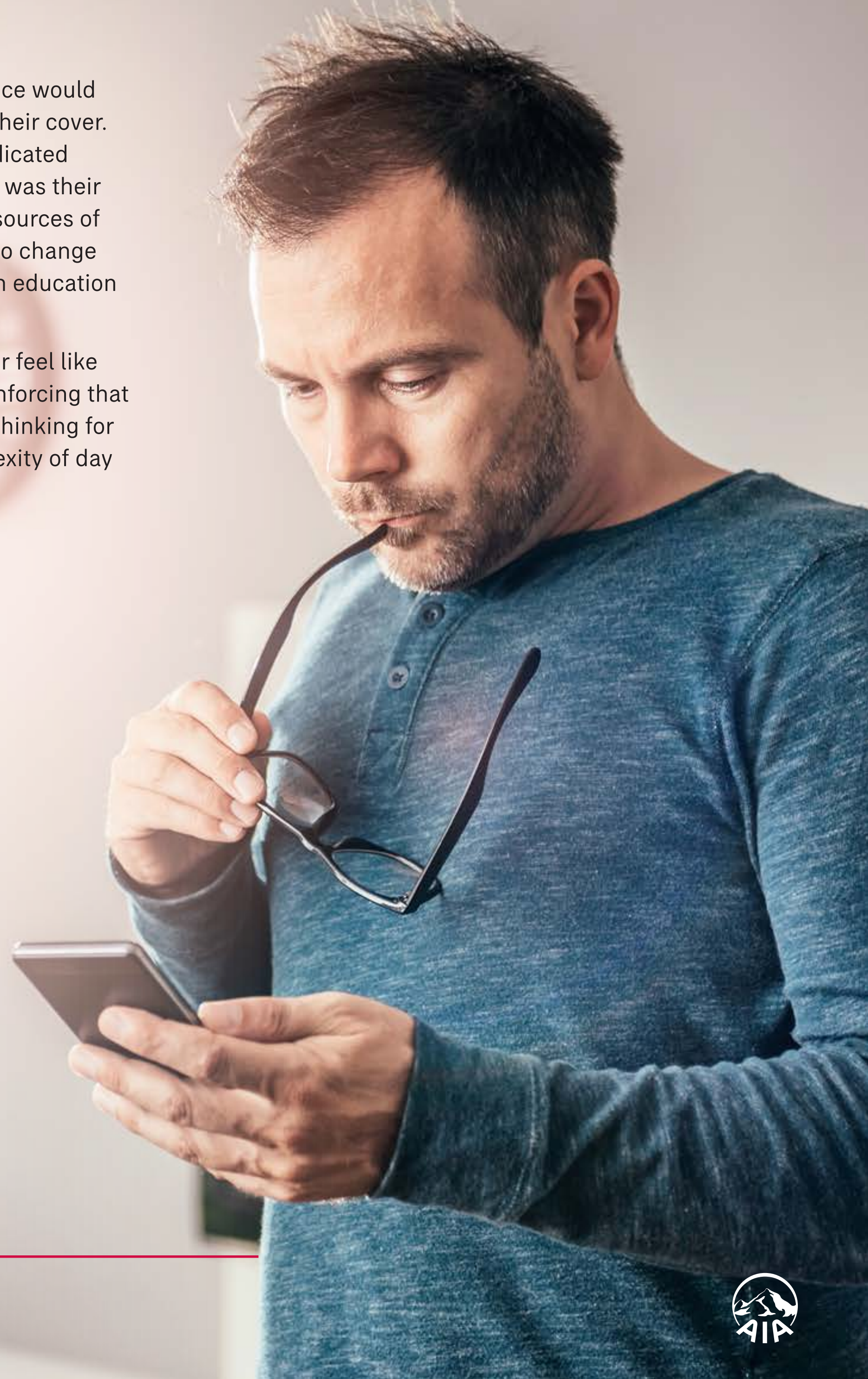
Barriers that prevent action

The research identified four main barriers four prevented a member from making changes.

- Takes too much time or effort
- Don’t know where to start
- Don’t know what level of cover I need
- It’s too complex

We asked consumers what sources of assistance would help them when they were looking to change their cover. Almost one in two (45%) of those surveyed indicated that guidance directly from the fund or insurer was their preferred source of assistance. Other popular sources of help included an online written guide on how to change cover, guidance from someone they knew or an education tool that provided a recommendation.

Trustees can also assist by helping the member feel like they have ‘ticked something of their list’ by reinforcing that this is important, and we’ve done some of the thinking for you, as they struggle with the pace and complexity of day to day living[1].



1. AIA Life Insurance Debrief research, November 2017.

Overcoming behavioural biases

Once a member has made a decision to review their cover, the challenge is the member acting on those intentions. There are four main behavioural bias' which explain people's failure to act:

Too much information causes a person to filter most information out and rely on shortcuts to reach a decision. Once cover is in place, a member will base decisions on the relative increases or decreases in cover rather than making a fresh holistic assessment of their needs.

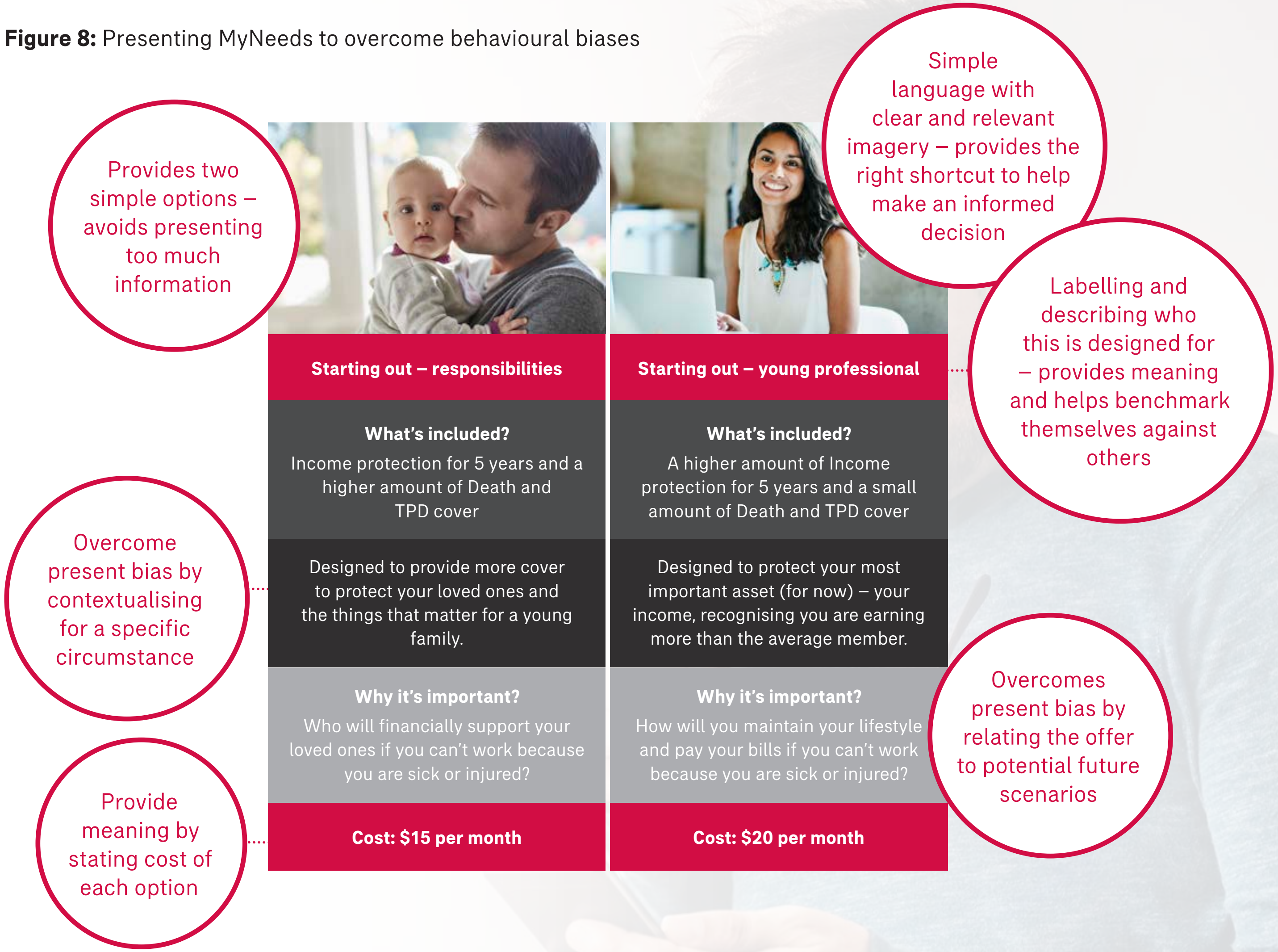
Present bias – make it hard for people to see future scenarios and value immediate rewards disproportionately higher than rewards that come in the future. Insurance and super by nature are future benefits, making it more difficult to understand the need in the present.

Need to act fast – means consumers may not take the time or attention to fully evaluate all the available information about a particular decision. Members may maintain their existing cover for fear of making a mistake in changing their cover, particularly given the complexities of insurance in super. Effective shortcuts can be provided to help consumers make an informed decision.

Not enough meaning – results in simplifying something to make it easier to think about, particularly when the topic is unfamiliar – as insurance in super often is. When presented with an insurance offer that may be more suitable for them, members may be influenced by their existing feelings about their super fund and insurance. Members may try to assimilate life insurance with other types of insurance to help increase understanding.

Using the MyNeeds concept, Figure 8 illustrates a practical example of how these biases can be overcome.

Figure 8: Presenting MyNeeds to overcome behavioural biases



Consumers reinforced the need to use multiple channels, including the use of emails and text messages as these are more likely to drive action and are critical in maximising engagement.

Appendix 3 includes strategies for overcoming these behavioural biases.

Barriers to implementation

We acknowledge there are challenges involved in implementing these concepts.

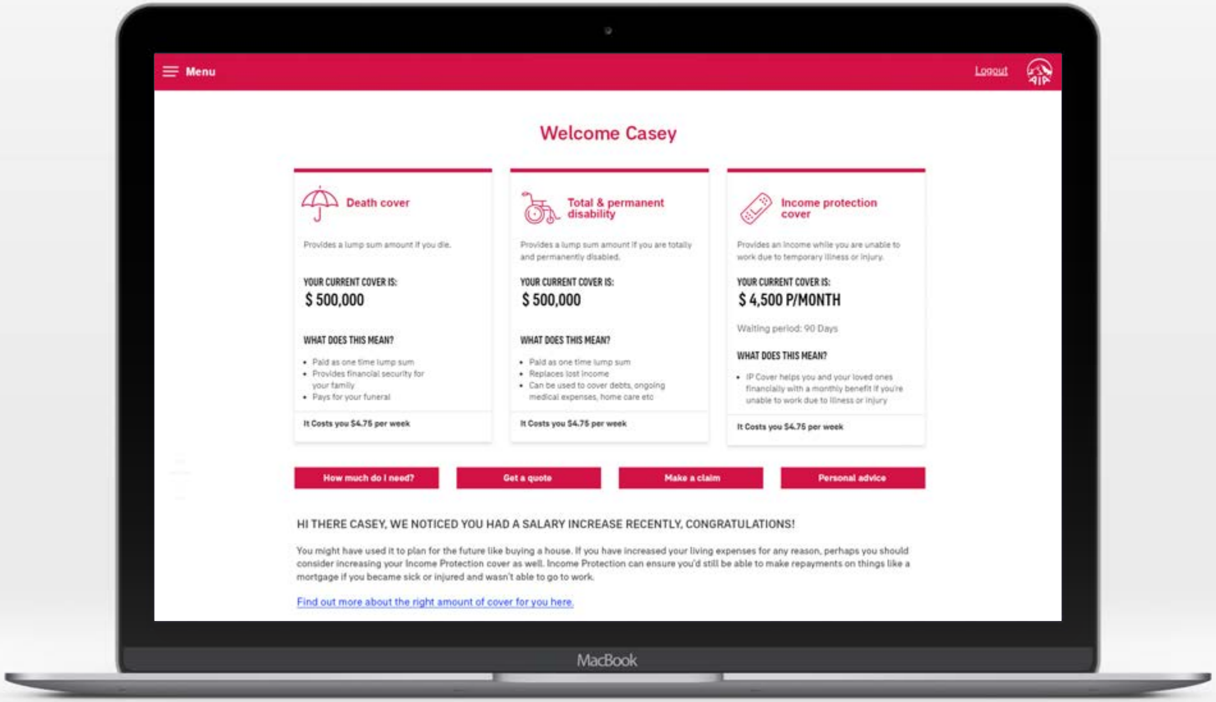
Administration

Administration systems would need to be enhanced to implement these concepts. Apart from these difficulties, current system restraints should not be a reason to stifle product development that better targets default cover. Administrators are increasing their technological capabilities and agility. A staged approach, perhaps adopting the MyNeeds concept initially and building to more dynamic updating of default cover, could be one way of making incremental changes.

Similarly, leveraging the increased touch points the ISWG Code prescribes, could allow some of the key principles to be adopted as part of a staged implementation.

Impact on premium

In considering these concepts, we are not implying default cover levels need to increase to meet an individual member's personal needs, rather, its about ensuring the basic cover provided is better targeted. Balance erosion remains a critical consideration for trustees and insurance costs should not inappropriately erode member balances. These concepts suggest more flexible tailoring to ensure appropriateness of cover for a larger cohort of the membership, with building blocks to empower members to customise cover for their individual circumstances.



Disclosure and simplicity

On face value, these concepts could be difficult to explain to a member. While a concept may be difficult to build or administer, it doesn't have to be difficult for the member.

These concepts may be complex 'under the hood' but communication to individual members is simplified because what is communicated is appropriate for that individual or cohort. The challenge is in explaining how the product is dynamic and recalibrated for a member's own circumstances.

One way of overcoming this challenge could be utilising digital capabilities to provide targeted communication about insurance offers at the right time.

AIA's LIFEapp Educate prototype is an example of a digital tool that allows a member to complete their personalised pathway and provide information about their circumstances. In this interaction the member does not need to see a complicated document outlining every bundle of cover available for every different cohort. They just need to see what is relevant for them.

Conclusion

There is a clear role for insurance in super and without this vital safety net of cover, the quality and lifestyle of many Australians and their dependents would be compromised in the event of sickness, injury or death. However, there is opportunity to improve the current system and actions that trustees with their insurers can implement now.

The future of default insurance in super needs to change to meet the rapidly changing regulatory environment, provide better member outcomes and keep pace with member expectations.

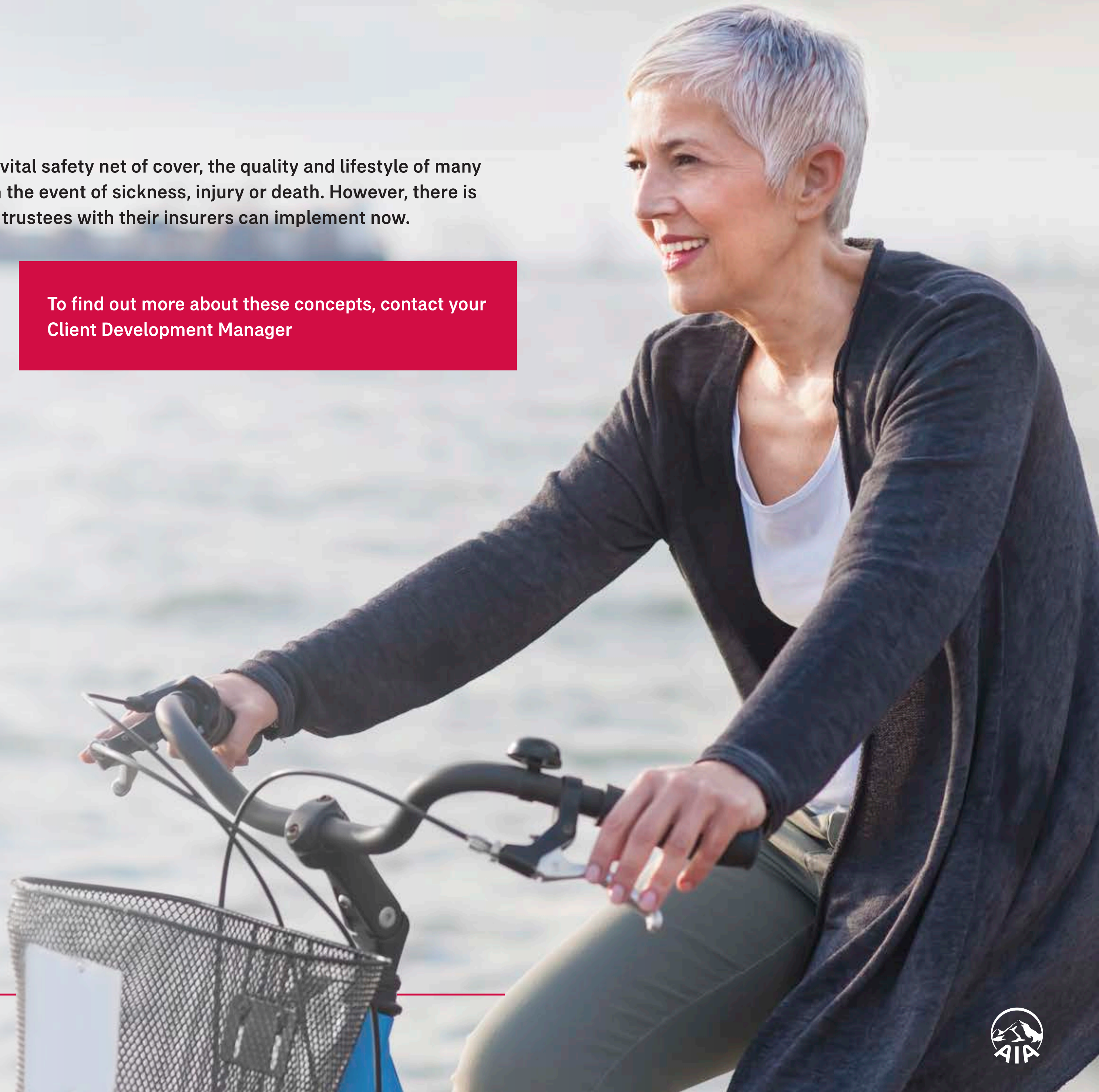
There are clear opportunities to reset the default insurance benefit design to be appropriate for a broader reach of the membership and ensure insurance in super remains fit for purpose, especially for the most disengaged of members. We have presented concepts we believe can achieve this.

To find out more about these concepts, contact your Client Development Manager

What else is coming?

This paper has focused on tailored and dynamic default insurance benefit designs. We also see an alternative future state of default insurance in super offering basic and standardised levels of default cover and universal terms across MySuper products. In this context, we see opportunities for funds being able to use member data to truly tailor cover to the individual's needs offering the right bundle of cover both inside and outside super. This includes a funding model factoring in a member's salary, liabilities and assets.

A further white paper will be released in 2020 which explores the future ecosystem that offers basic default product within super with customisation of other risk protection through solutions both inside and outside super.



Appendix 1: SmartCover design – other considerations

Appropriate recalculation period

Different employers within a fund will pay SG contributions at different frequencies – fortnightly, monthly or quarterly. To simplify administration, this may lend itself to an annual recalculation of cover on the same date for all members. Alternatively, recalculation could occur on an individual member's yearly anniversary of membership with the fund, albeit this could be more difficult to administer.

Changing cover too regularly for a member may cause confusion and lack certainty of cover.

Increases and decreases to cover

The purpose of the design is to ensure members are appropriately insured to avoid members being under insured or over insured. Trustees should consider whether a member's sum insured is automatically decreased as well as increased. Rather than automatically decreasing cover a trustee may wish to let the member know they could be over insured and may not receive their full sum insured in the event of claim. This would give the member flexibility to retain the higher sum insured if this is appropriate for their circumstances.

Uplift to salary during recalculation period

Trustees with their insurers should consider how to address salary increases during the recalculation period. This could include agreeing to increase the sum insured up to a pre-determined cap on salary increases in the event of claim where a salary increase has occurred since the last recalculation.

Over insurance – additional benefit paid to super

If a member is over insured and the benefit payable is less than their sum insured, any additional amount could be paid as a super benefit. This means a member is receiving the full value of what they're paying for. As the additional benefit is being paid into a member's super account rather than a cash benefit, adverse behavioural changes or resistance to return to work, is mitigated.

1% premium cap

One of the challenges with this design (particularly for IP where cover is adjusted automatically) is ensuring cover levels remain sustainable and within the 1% premium cap required under the ISWG Code. One way to mitigate this could be setting an Automatic Acceptance Limit (AAL) which still allows the majority of members to be insured for a reasonable portion of their salary. Alternatively, a trustee could retain a default scale and allow members to 'opt-in' to a SmartCover automatic recalculation design. This would mean the member is no longer subject to the cap.

Appendix 2: Optional SuperStream fields that could be used

Field	Description	Use
Employment start date*	The date the member commenced working with the employer.	Usually the date a member's cover commences. Could show when a member has changed jobs.
Employment end date*	The date the member ceased working with the employer.	Could help identify when a member's account may begin to become inactive, or where alternative definitions might apply (for example a stricter TPD definition if the member is unemployed). This could allow a trustee to issue timely communication to the member to warn of this change. A combination of employment start and end dates could help the fund understanding employment patterns, tenure and demographics.
Employment end reason	Open text field.	Help identify members who may have ceased employment due to illness or injury who could be eligible to claim. It could identify any trends where insurers may be able to assist with early intervention or help prevent the person ceasing work (i.e. mental health)
At Work indicator	True = member is at work on employment commencement date False = member is not at work on employment commencement date.	Whether the member was At Work is usually tested at claim stage. Having this information could potentially provide better transparency to members about limitations on their cover and remove the need to verify this as part of a claim assessment.
Annual salary for insurance amount*	The salary used to calculate insurance amounts (although could be used to just report salary even where insurance cover is not dependent on salary).	Salary could be used as a measure for determining insurance needs. It could also be used to set the appropriate level of cover and benefit design to stay within the premium cap of 1% of lifetime salary (as prescribed under the ISWG Code).
Weekly hours worked	The usual hours of work per week for that employee.	Assist in understanding work patterns and design cover accordingly or identify where a switch in definition might apply (i.e. different TPD definition if the hour's threshold is not met). This could allow a trustee to issue timely communication to the member to warn of this change.
Occupation description	The main salary earning occupation for that member.	Assist in understanding fund demographics and tailor insurance needs, for example white collar and hazardous workers may have different insurance needs.
Employment status code*	Casual, contractor, full time, part time.	Assist in understanding employment patters and demographics as well as being able to communicate to members if there are changes to insurance terms as a result of employment status. Will also allow a trustee to tailor insurance cover, for example full time employees may have different insurance needs to casual employees.

* Denotes fields also available through Single Touch Payroll (STP).
Some of these fields are already available through Single Touch Payroll and could be another means for trustees to obtain this data from employers.
Given these data sources currently exist within employer payroll and HR systems, it could be an opportunity for this data to be shared through SuperStream.

Appendix 3: Behavioural Economics bias' and strategies

Problem	Impact	Strategy to overcome
Too much information	Too much information means people will filter most of it out and rely on shortcuts to reach a decision. Once cover is in place, a member will be influenced by increases or decreases in cover rather than making a fresh holistic assessment of their needs. A members perceived value of insurance cover could be influenced by the member's view of whether they are likely to need to claim in the future.	Clear and succinct explanations of who each bundle of cover is designed for. Members need to receive communications tailored for them and offer customisation of any offers and real stories that show them what people like them have and do. When presenting members with alternative cover, clearly decouple the new recommendation from the existing cover explaining why the recommendation is more relevant to the member's situation.
Present bias	Consumers may struggle to see future scenarios and rely on their current circumstances to make decisions. For example, a member in good health may not be able to picture sickness or injury in the future and the financial impact it may have on dependents. Insurance and super by nature are future benefits, making it more difficult to understand the need and value in the present.	Any new recommendation should clearly explain why this is relevant to the member's present circumstances. "You recently mentioned to us you just had a baby. We think this bundle of insurance cover is better suited to your needs now you have someone who is dependent on you. This will help ease the financial burden on them if something were to happen to you" Offering prompt and targeted offerings and communications to member after material changes in their circumstances may also better assist in members drawing relevance to the insurance recommendation or offer and their present situation. Trustees can attempt to overcome this bias by linking a present day reward to the member's decision to invest in a possible future benefit. This could include a trustee highlighting the 'peace of mind' a member will feel from taking action knowing their insurance is in order, should something happen. Health and wellbeing programs, such as AIA Vitality, could offer present day rewards to members who do review their insurance arrangements.
Need to act fast	People cannot analyse and rationally evaluate every decisions – short cuts are needed to help make decisions and avoid adverse outcomes. Members may maintain their existing cover for fear of making a mistake in changing their cover, particularly given the complexities of insurance in super. Members are more likely to favour options that are simpler and offer more complete information as opposed to complex options.	Explanation of new insurance options needs to use language a member can understand, with relevant pictures and diagrams where possible to simplify.

Problem	Impact	Strategy to overcome
Not enough meaning	After filtering information, people will still have a tendency to fill the gaps in understanding with things they already know. This also leads to people simplifying probabilities and numbers to make it easier to reconcile. When presented with an insurance offer that may be more suitable for them, members may be influenced by their existing feelings about their super fund and insurance. Members may try to assimilate life insurance with other types of insurance to help increase understanding.	Members generally have no reference point to compare cost or type of cover that may be appropriate for them. Linking the premium payable for their current benefit vs recommended or offered benefit as well as highlighting why one may be more or less expensive than the other can help fill this gap. More generally, linking premium cost of insurance in super to other types of insurance could help the member understand the perceived value of the premium. Another important approach is to explain to members what insurance cover other members like them (age, gender, occupation, earnings) have and/or what similar members pay for insurance cover.

About AIA Australia

AIA Australia Limited is an independent life insurance specialist with over 46 years of experience building real and sustainable partnerships. AIA Australia offers a range of products that protect and enhance the lives of over 3.5 million Australians and is a market leader in product innovation and development.

AIA Australia is the country's second largest group life insurer by market share and works closely with major financial institutions and corporate partners to provide life insurance solutions. In addition, AIA Australia is the fastest growing provider of retail life insurance products sold through financial advisers. AIA Australia also works with affinity partners who distribute life insurance products.

In 2014, AIA Australia introduced 'Vitality' – the world's leading scientifically-backed health and wellness program – to Australia. AIA Vitality aims to enable real change for positive health outcomes.

In 2017, AIA Australia launched myOwn to bring together health insurance with the AIA Vitality wellness program to help its members live longer, healthier, better lives. myOwn is a joint initiative of AIA Australia, not for profit health fund GMHBA and South African financial services provider Discovery.

AIA Australia has received multiple insurance industry awards, including the ANZIIF Life Insurance Company of the Year (2017, 2015, 2013, 2012), Super Review's Best Insurer of the Year (2019, 2018, 2017, 2016, 2014, 2012, 2011), AB+F Life Insurance Product of the Year (for AIA Vitality in 2018, 2017 and 2016), ANZIIF Women's Employer of the Year (2017, 2016, 2013 and 2012) and three AFA & Beddoes Institute Consumer Choice Awards (2016).

AIA Australia

509 St Kilda Road
Melbourne VIC 3004
aia.com.au

HEALTHIER, LONGER, BETTER LIVES

AIA Australia Limited (ABN 79 004 837 861 AFSL 230043)
12/19 – GI4841