

Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry

Written Submission by Anthony Asher in response to policy-related issues raised in the
MODULE 6: INSURANCE POLICY QUESTIONS

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(Broad responses to specific questions are given on page 7 and 8, and a brief response to IPQ 3 on page 11.)

1 Introduction

This submission is intended to highlight, firstly, differences between insurance and other economic services, and secondly, the fragmented and clumsy nature of government intervention and regulation in response to these differences. I propose that the Royal Commission (RC) consider the following recommendations:

- the removal of insurance from the Corporations Act,
- the creation or nomination of a body to take overall responsibility for co-ordinating government interventions and regulatory responsibility, and
- extending the purpose and scope of the regulators to that of optimising insurance coverage of the population rather than its current narrow focus on prudential and competitive matters.

My experience (practical and academic) is mainly in Life Insurance, but I do make some comments on health insurance¹ and personal lines, but not commercial lines of insurance. I have mainly focussed on the general principles, agreeing with the assessment that:

*... in design and application, the normative question of why one regulates trumps the technical consideration of how one regulates, which is a second-order consideration.*²

Section 2 of this submission makes the traditional case that insurance is not a normal economic good. Section 3 goes on to suggest that Australian regulation would be more effective if it reverted to the traditional approaches to regulation. Section 4 suggests how the many government interventions in insurance markets (that include regulation and several mandatory covers) might be co-ordinated.

2 Insurance pools and their protection

That insurance is not a normal good is indicated by over 3 centuries of regulation, and by government interventions to extend coverage. This section also shows that the regulation and interventions are somewhat fragmented. The implication is that coordination is required.

Insurance pools have the social and economic function of providing financial security: protecting families against significant loss of income from death and disability, and against

¹ Appreciating it is outside the RC's terms of reference.

² O'Brien J (2013) "Back to the future: James M Landis, Regulatory Purpose and the Rationale for Intervention in Capital Markets." In O'Brien, J. and Gilligan, G. eds., 2013. *Integrity, risk and accountability in capital markets: regulating culture*. Bloomsbury Publishing.

loss of significant assets. The benefits paid are intended to prevent people falling into poverty or needing to claim social welfare.³

The pools cannot function effectively in an unregulated market. Regulation – to ensure that policyholders have an insurable interest and have a duty of utmost good faith to disclose all relevant facts to the insurer – goes back at least to the 18th century.⁴ These regulations have allowed for the expansion of insurance pools by reducing uncertainty and “moral hazards”. The need for an insurable interest distinguishes insurance from gambling and reduces the incentives to engineer an insurance claim. Utmost good faith makes it easier for insurers to classify risks, and to charge fair premiums that match the risk of claim to the premiums.

Economists have been analysing the moral hazards and information asymmetries for over a century.⁵ The best analysis recognises that these are “market failures” and require regulatory interventions:

*... the price system is intrinsically limited in scope by our inability to make factual distinctions needed for optimal pricing under uncertainty. Nonmarket controls, whether internalized as moral principles or externally imposed, are to some extent essential for efficiency.*⁶

Much economic analysis cannot however be trusted; some making Procrustean attempts to fit insurance into an unregulated self-interested market. A thorough refutation of the worst analyses is given by Guy Thomas, whose book is reviewed thus:

Thomas also exposes myths of insurance economics, including Rothschild–Stiglitz, Miyazaki, Wilson, Spence⁷, and related classic equilibrium model extensions, that

³ Provision of the latter is resented by some taxpayers and some eligible people experience shame. CF Manchester and KJ Mumford, ‘How costly is welfare stigma? ‘Separating Psychological Costs from Time Costs’, 2009, <http://ssrn.com/abstract=1544601> (accessed 3 April 2016).

⁴ Insurable interest came in the British Marine Insurance Act 1745 and the Life Assurance Act 1774 while *uberrima fides* seems to have been first defined in *Carter v Boehm* (1766) 97 ER 1162, 1164,

⁵ Rowell, D., & Connelly, L. B. (2012). A history of the term “moral hazard”. *Journal of Risk and Insurance*, 79(4), 1051-1075.

⁶ Arrow, K. J. (1968). The economics of moral hazard: further comment. *The American Economic Review*, 58(3), 537-539.

⁷ Miyazaki, H., 1977, The Rat Race and Internal Labor Markets, *Bell Journal of Economics*, 8(2): 394-418; Rothschild, M., and J. E. Stiglitz, 1976, Equilibrium in Competitive Insurance Markets: An Essay on the Economics of Imperfect Information, *Quarterly Journal of Economics*,

90(4): 629-649; Spence, A. M., 1978, Product Differentiation and Performance in Insurance Markets, *Journal of Public Economics*, 10(3): 427-447. Wilson, C., 1977, A Model of Insurance Markets with Incomplete Information, *Journal of Economic Theory*, 16(2): 167-207.

have been highly influential on theory and frequently applied in policy recommendations, despite being notoriously unreflective of actual real-world markets. Thomas refutes numerous myths, including: adverse selection always implies “efficiency loss,” a small high-risk group poses big problems, deductibles make good screening devices, insurance for low risks is rationed, coverage for high risks is never rationed, and high and low risks differing only in risk must share uniform other endowments. Thomas also debunks several biases relating to asymmetries of information and behavior, as well as the common notion that any transfer from low to high risks through taxation or benefits is always superior to bans on risk classification schemes.⁸

Thomas’s main thesis is that insurance meets its social purpose by paying as many claims as can be covered economically. Intervention that prevents “competitive selection”, where companies compete for the lowest risks by offering cheaper premiums, can be beneficial. An obvious example is banning genetic testing for life insurance. Another is the problem currently faced by Australian life and disability insurers where the better risks (those in good health) churn. This leaves unhealthy people behind in pools where the premiums must be increased to take the higher claims in to account. This is, obviously, aggravated by perverse sales commissions, but could be a problem even without commissions.

2.1 Government intervention

Not everyone vulnerable to economic shocks has the foresight and ability to buy the insurance they need. Governments therefore intervene in different, but not always coherent, ways. Although some of these interventions are beyond the remit of the RC, they have important impacts on the structure of private markets that are within its scope. The following provides a list, which may not be complete:

- The provision of social insurance normally provides an income floor in the event of disability or unemployment. In Australia, there is also Medicare.
- Most countries have compulsory retirement benefits schemes – often with compulsory life, disability and longevity insurance (i.e. life annuities). Australia’s superannuation is unusual in not requiring some compulsory annuitization.
- Cover against accidents at work and on the road is usually made compulsory. These arrangements originated partly to ensure that employers and drivers took responsibility for harms they created.⁹ The by-product is that they also provide *incomplete* cover against accidental death and injury. The incompleteness is partly addressed in New Zealand by a national no-fault accident compensation scheme¹⁰, which does not, however, cover death and injury caused by disease. Benefits may also be insufficient to cover family members’ losses.

⁸ Ferguson, William L. (2018) Book Review: Loss Coverage: Why Insurance Works Better with Some Adverse Selection, by Guy Thomas, 2017, Cambridge, UK: Cambridge University Press, *The Journal of Risk and Insurance*. Vol. 85, No. 3, 865–867

⁹ Epstein, R. A. (1981). The historical origins and economic structure of workers' compensation law. *Ga. L. Rev.*, 16, 775.

¹⁰ <https://www.acc.co.nz/>

- Private Health Insurance is encouraged by tax benefits and is subject to regulations requiring minimum levels of cover, “community rating” for premiums.
- Government has intervened in the definition of flood in the Insurance Contracts Act (ICA), sections 37A to 37E.
- State governments levy households or insurers for fire services.
- The *Terrorism Insurance Act 2003* provides re-insurance for terrorism.
- Many countries exercise price control on insurance premiums and commissions; restrict benefit and product structures, and limit shareholder participation in profits. Policy in Australia has moved away from this in the past three decades, but residues remain in Private Health Insurance, the CTP and workers’ compensation schemes, in APRA’s *Prudential Standard LPS 360 Termination Values Minimum Surrender Values and Paid-up Values*, and the restrictions in the Life Insurance Act Section 60 on the distribution of profits.

The fragmented nature of regulation has been noted in the case of the development of longevity insurance, which has led recently to a cross agency process – led by the ATO – for seeking initial “concept exploration” or “product review” from the relevant agencies (ATO, APRA, ASIC and DSS).¹¹

2.2 Company collaboration

Traditionally, Insurance companies also collaborated on ways to ensure the integrity of insurance pools. In my experience in South Africa, the insurers created a register of salespeople who failed to maintain ethical standards; a register of claims to prevent duplicate and fraudulent claims and created agreements to prevent unreasonable investment projections. I am aware that there was also a projection agreement in Australia. The actuarial profession also used to collect industry wide mortality and disability data. Competition law has made such collaboration more difficult, and the increased powers of the regulators have shifted the onus of maintaining standards from the industry. Such self-regulation, however, has several shortcomings, and needs to be supplemented by active regulation.

3 Australian law and regulation

This section covers the principles of equity that I believe should lead legislation, but which have been diluted by current regulation, possibly as a consequence of regulatory capture.

3.1 Utmost good faith

The general law requirement to act with utmost good faith takes insurance contracts out of the realm of *caveat emptor* into one where both parties are expected to be entirely frank and

¹¹ <https://www.ato.gov.au/Super/APRA-regulated-funds/In-detail/APRA-resources/Cross-agency-process-for-innovative-retirement-income-stream-products/>

respect the interests of the other. Given inequalities of power, however, it is perhaps not surprising that Catherine Larkin found:

Whilst the common law requires the parties to treat each other with good faith this has not been reflected in Australian case law. Indeed, when the ALRC made its Report on Insurance Contract¹² there were no reported Australian cases which applied the duty of good faith to the payment of claims. The overwhelming majority of cases have concentrated on the duty of good faith via the insured's duty of disclosure, rather than the issue of ongoing mutual good faith throughout the contract relationship.¹³

The final paragraph of her conclusion is that:

The potential for claims based on the duty of good faith is great. The very small number of cases that have been brought before the courts in relation to the duty indicate that either there are very few problems being experienced by parties to insurance contracts, or that parties, and their legal advisers, are largely unaware of their expanded rights and obligations either at common law or pursuant to the ICA.

Justice Kirby is effuse in his praise of the ICA (Insurance Contracts Act) as bringing “order out of chaos” but less so about subsequent amendments such as section 59A, which he describes as “difficult and cumbersome”, and “we can be excused if we yearn to free ourselves from the current torment with a sharp and bloody reformer’s axe.”¹⁴ One suspects he is also thinking of the Corporations Act here, and I would urge the RC to take up the axe he mentions. My view (and I think that of many if not most participants in the insurance industry) is captured by this, clearly deeply felt aside, by Justice Austin:

The very mention of the Financial Services Reform Act 2001 will produce moans of despair. It is not just the excessive detail and complexity of the drafting, the devastatingly comprehensive abandonment of the principles of simplification, that causes difficulties; it is also the extent to which the legislative text is affected by regulations and ASIC modifications, adjustments that evidently became necessary because of flaws in the formulation of policy and legislative text.¹⁵

If chapter 7 cannot be repealed in its entirety, there would be great benefit in exempting insurance from its clutches, although this might necessitate further legislation to prohibit conflicted payments for advice. The proposed Design and Distribution Obligations and Product Intervention Powers Bill (DDO Bill) seems to be in the worst of this tradition, and

¹² Australian Law Reform Commission (1982) *Report No 20 on Insurance Contracts para 328*

¹³ Larkin, C. (1995). *Uberrima Fides-Quo Vadis-Where to from Here. Bond L. Rev.*, 7, i.

¹⁴ Kirby, M. (2014), *Insurance Contract Law Reform—30 Years On*, *Insurance Law Journal*, 26, p.1.

¹⁵ Austin RP, “Opening Speech – Mergers and Acquisitions 2007” (University of New South Wales, Faculty of Law, 24 October 2007), http://www.supremecourt.justice.nsw.gov.au/Documents/Speeches/austin_speeches.pdf.

surely deserves condemnation. Almost 13,000 words of contorted process and compliance add nothing substantial to the regulatory armoury.

3.2 Reasonable benefit expectations

The general law covering Life insurance has also come to include the concept of policy owners' *reasonable benefit expectations*¹⁶ (RBE) as described in Box 1. RBE is particularly important in life and health insurance where individuals need the assurance that they will remain covered even if their health deteriorates, but companies cannot guarantee premium rates over the length of time required by the policyholders. The insurance companies must therefore retain the right to change premium rates, and possibly benefit structures, so that they remain solvent. This right must however be restricted to prevent exploitation of the policyholders.

Box 1¹⁷

“Reasonable benefit expectations” (defined as “Reasonable Benefits” in PS 200) play a particularly important role in determining equity in life insurance. The concept is used in the UK and South African courts, in Australia by APRA, (in Prudential Standard LPS 112: Measurement of Capital, and has played a role in actuarial reports for the court review of the transfer of business from Metlife to Challenger: see *Re Metlife Insurance Ltd and Challenger Life No 2 Ltd* [2007] FCA 937. The case has been made that reasonable benefit expectations are created by:¹⁸

- legislation and legislative practices;
- the constitution of the company, past and present;
- past practices of the company;
- what has been indicated to policyholders in the past by both employers and trustees; and
- practice by other companies or actuaries (noting that the term “industry practice”, sometimes used in this context, is incoherent because there is no competent body to determine it.)

It seems to me that applying the duty of (utmost) good faith and RBE provides an answer to many of the Insurance Policy Questions (IPQ). Insurers have an obligation to provide potential policyholders with all the information necessary for them to make an informed decision.

¹⁶ APRA Prudential Standard LPS 112 Capital Adequacy: Measurement of Capital. (My italics)

¹⁷ Taken from Asher, A (2013) “The Financial Management of Life Insurance”, in Wickens, The Law of Life Insurance in Australia, Thomson Lawbooks.

¹⁸ SL Smaller, P Drury, CM George, JW O'Shea, DRL Paul, CV Poutney, JCA Rathbone, PR Simmons and JH Webb, Ownership of the Orphan Estate *British Actuarial Journal*, (1996) 10: 1273-1322, Appendices 1 and 3

- IPQ A: *Products* should clearly be designed with consumer needs in mind, and not be offered if there is no real need for them.
- IPQ B: The black letter of the current regime on *disclosure* is hopelessly inadequate, and the onus should be on insurers to provide adequate information to policyholders as to when they are likely to need the cover.
- IPQ C: *Sales* information (not “advice”) should similarly set out the advantages and limitations of a product and give an indication of where appropriate advice can be found.
- IPQ D: *Add-on insurance* should similarly not be permitted unless it is an inherent requirement of the basic product, or specifically requested by the customer.
- IPQ E: *Claims should also be handled* in line in good faith and in line with customers’ reasonable expectation.

If any of these conditions are not met, then it would seem to be open to a regulator, or a class action funder, to apply for the payment of compensation to disadvantaged policyholders. The recent PPI compensation provides an example of how this can be possible. I am not able to make any more useful responses to question IPQ4 on disclosure, although I would hope that section 33C of the ICA provides scope for the necessary regulatory actions.¹⁹

3.3 *Insurable interest*

Part III of the ICA removes the need for insurable interest. While this recognises the Australian love of gambling, I am not sure that the impact is wholly beneficial as it must encourage over-insurance. Given that over-insurance ultimately benefits the industry and represents a temptation to greed, there are arguments for removing the Part, or at least limiting its impact. The RC might refer the matter to the oversight regulator proposed in this submission.

3.4 *Derivative investment contracts*

One of the intentions of incorporating all financial contracts under the corporations legislation was the need to address the convergence of insurance and investment markets. While there is a need for some consistency of treatment between investment guarantees in life insurance contracts and derivative investment instruments, the latter are often in the nature of gambles and are not insurance contracts. I do not think anything is lost by seeing them as investment instruments solely.

4 **A vision of collaboration**

If competitive markets will not provide efficient insurance markets, and the current state of government intervention and regulation is recognised as fragmented if not incoherent, the question arises: can one envisage a new model of collaboration between industry and regulators, with safeguards against regulatory capture? This thought has been partly captured

¹⁹ Possibly requiring the addition of civil penalties suggested by Treasury (2017) *ASIC Enforcement Review, Positions Paper 7 Strengthening Penalties for Corporate and Financial Sector Misconduct*, p 70

by Part 1A of the ICA, although it is not sufficiently wide in scope, and the regulation of the industry is divided not just between APRA and ASIC, both of which are constrained to promote competition, but also between the other bodies mentioned in 2.1 above.

There needs to be a body with the responsibility for addressing the objective to *extend the benefits of insurance to protect members of the public against financial shocks*. Such a co-ordinating body would have the scope to address all private and public insurers: life, disability, health, accident (including CTP and workers compensation), motor and home insurance. One possibility is an overall co-ordinating body with a similar structure to The Board of Taxation. An alternative would be to house the responsibility within an existing regulator, which should probably be APRA rather than ASIC, given the latter's already large remit.

4.1 Regulatory objectives

The body would have the following objectives:

- **Prudential regulation** of insurers so that they are reasonably certain of paying insured benefits. Included in this remit would be responses to catastrophes, which might require government financial support (as with terrorism), or “resolution plans” as to how claims would be reduced in the event of the bankruptcy of companies such as occurred after the Christchurch earthquake.
- **Policyholder protection**, which would include making sure that products were fit for purpose, that prices and claim processes were reasonably fair, and that reasonable benefit expectations are met. This would be a positive aim, as against the proposed DDO Bill, which, for all its prolixity, merely addresses “significant detriment”.
- **Optimisation of coverage**, by considering the extent of mandatory cover – ensuring that there are no significant gaps in coverage – or that gaps in coverage are highlighted clearly.
This would also involve education; ways in which government could contribute to the collection and distribution of on-line data that could be used to facilitate people making financial decisions; managing the remuneration of financial intermediaries and advisors and the role of advertising – endeavouring to ensure that the public is not misled.
An important element would be to limit the rating factors (such as genetic markers) used so as to increase loss coverage and prevent competitive selection.
- **The encouragement of innovation.** This would include research by collecting data on claim rates, and the impact of insurance on poverty reduction and the needs of policyholders. This should include collaboration with universities and other government departments. Box 2 suggests a further method of promoting the innovation that often seems missing in the Australian industry.

Box 2²⁰**Lack of intellectual property protection**

Innovation may also be constrained by the lack of intellectual property (IP) protection. Neither patents nor copyright offer protection to innovators, making it more difficult to justify an investment in a new product or method of doing business. I have personal experience of this difficulty in developing the product set out in Asher (2011)²¹.

It seems generally agreed that IP encourages innovation. Some type of IP for financial products might do the same. My thoughts are that such an instrument might dispense with the patenting requirement that an invention be non-obvious and novel by a measure of whether the product was currently available in the market. A potential supplier might apply for a short term (say 5 year) exclusive licence.

4.2 Addressing regulatory capture

Ultimately regulatory capture requires vigilance by everyone from politicians and voters to institutions and shareholders. Braithwaite's suggestion is that "we abandon arraying guardians in a hierarchy. Instead, we can array guardians in a circle where every guardian is accountable to every other guardian (as much as possible)."²² Some ways of doing this are, that might be considered as recommendations by the RC:

- The appointment of advisory committees for life, general and health insurance with elected representatives from industry, consumer groups and relevant university departments.²³ Representatives appointed by government will inevitably have less confidence to challenge regulatory capture. The minutes of such advisory committees should be public.
- Data collected by the regulators should also be made public.²⁴ Items that might unnecessarily expose insurers to a crisis of confidence can be released after a delay – of perhaps two years.

²⁰ Taken from Asher, A (2016) Productivity Commission Superannuation Competitiveness and Efficiency Review: http://www.pc.gov.au/__data/assets/pdf_file/0003/198075/sub021-superannuation-competitiveness-efficiency.pdf

²¹ Asher, A (2011) "Salary Linked Home Finance: Reducing interest rate, inflation and idiosyncratic salary risks", *Australian Actuarial Journal* 17.1: 117-148

²² Braithwaite, J (2013) *Cultures of Redemptive Finance*. In O'Brien, J. and Gilligan, G. eds., 2013. *Integrity, risk and accountability in capital markets: regulating culture*. Bloomsbury Publishing.

²³ My experience of membership of such committees in South Africa were that they did provide scope to escalate issues of importance. See Asher, A (2015). *Working ethically in finance: Clarifying our vocation*. Business Expert Press. p32-35.

²⁴ See also Zingales, L., 2015. Presidential address: Does finance benefit society? *The Journal of Finance*, 70(4), pp.1327-1363, p1352.

In addition, as suggested in my submission to module 5, there needs to be a Consumer Advocate – possibly within the Treasury – with a specific remit to address issues of rent seeking and regulatory capture at APRA, ASIC or the RBA.

5 Miscellaneous additional comments

I raise four other issues that the RC may find useful to note. They are however matters of detail that I think are better referred to an active regulator with oversight of the whole insurance sector.

5.1 Unsuitable products

The RC has identified funeral insurance and accident benefits as products sold for their profit rather than the benefit to the policyholder. The sale of TPD and Trauma can be added to this list. Like funeral and accident benefits, they can appear to add value. After all, who would not benefit from additional money after one of the insured events? The question is rather whether the money will really be needed and is therefore related to the question of insurable interest. The appendix makes the arguments that these products are often closer to gambles and mislead or leave huge gaps.

5.2 Polarization between independent and tied advice

The UK Financial Services Act 1986 introduced polarization, which the RC might consider as an option:

*The Board has adopted polarization, the principle that salesmen of unit trusts and life insurance must make clear to customers whether they are independent or are acting as representatives of the insurance company or unit trust operator producing the product.*²⁵

It was not however politically sustainable and was abandoned in 2004.²⁶ While it has its attractions, it may be that a complete ban on conflicted payments is ultimately more sustainable.

5.3 Medical definitions

IPQ 3 Should the requirements of the Life Insurance Code of Practice in relation to updating medical definitions be extended to products other than on-sale products?

Given the arguments in the appendix item **Error! Reference source not found.**, I do not think Trauma insurance serves a real need and is in fact a type of gamble. To the extent that this is true, the concept of updating definitions is arbitrary: it depends on the latest idea to

²⁵ Miller, Sam Scott. “Regulating Financial Services in the United Kingdom—An American Perspective.” *The Business Lawyer*, vol. 44, no. 2, 1989, pp. 323–364.

²⁶ <http://researchbriefings.files.parliament.uk/documents/SN00792/SN00792.pdf>

emerge from the marketing department as to which diagnosis will be regarded with the greatest fear in the next year. It is difficult if not impossible to legislate.

5.4 *The impossibility of regulating financial advice for insurance*

I have already made the point that there is no agreement as to what constitutes financial advice in my submission to Round 5 (Section 5.3). This lack of agreement and expertise extends to life insurance, and the evidence suggests that neither the regulator nor the industry have the capability to regulate the quality of advice.

Start with the amount of life and disability insurance required. Go to the ASIC website and they will say you need to consider your debts, costs of childcare, education and the amount of income your family will need if you pass away.²⁷ They then refer you to an insurance calculator:

There are many online insurance calculators to help you work out how much cover you should have. It's a good idea to check a few different calculators to see a range of recommendations for your circumstances.

This is better than it has been previously, because the site used to refer directly to the “Lifewise calculator”.²⁸ This is incoherent, suggesting that you need income protection for your children but then suggesting cover for your disability but not death (except to cover debts). The children would need both. It also refers you to additional information about inflation and rates of return that will certainly confuse users. Lifewise is sponsored by the Financial Services Council, the peak body for the industry.

So long as those offering financial advice as to the types and amounts of insurance sold are not remunerated by the insurers or their agents, it does not seem helpful to licence them.

²⁷ <https://www.moneysmart.gov.au/insurance/life-insurance>

²⁸ <http://www.lifewise.org.au/calculator>

Appendix – Over insurance and gaps

I drafted the following criticisms of insurance products while working on what was to have been a new insurance business in 2013. It suggests how a company might meet its good faith obligations to meet needs.

Over-insurance

You need insurance to protect yourself and your family against death, disability, sickness and losses from accidents and natural disasters.

Insurance companies and financial advisers obviously want to sell you more, and may well offer you more than you need. It may seem great to receive extra money after a financial shock, but there has to be a balance between present lifestyle and uncertain payments.

From Financial Observer (22 March 2013) , Krystine Lumanta

... APRA member Ian Laughlin said at the Financial Services Council 2013 Life Insurance Conference in Sydney. "One of those [factors] is the never-ending desire to add and have more bells and whistles than the next insurer," Laughlin said. "There is no way that is driven by customer needs; it's driven by a desire to get a higher score from the ratings houses, which in turn gives rationale for an adviser to move from one company to another." The issue, which had been around for many years, was one the industry had to come to grips with, he said.

<http://www.financialobserver.com.au/articles/on-essential-product-features-a-risk-to-profitability>

(i) TPD

Lump sum disability insurance, which will only pay out if you are both totally and permanently disabled (TPD).

It includes two traps for the unsuspecting:

- Because large amounts of money are involved it can lead to legal disputes about whether the claimant is totally and permanently disabled or not. There is lots of evidence that being in legal disputes is bad for your health.
- The prospect of a claiming a large amount of money also provides a disincentive to fully recover.

It leaves two gaps in coverage:

- It does not cover situations where you are partially or temporarily disabled. This leaves members without protection if they are not both totally and permanently disabled.
- Lump sum TPD claims often reduce the life cover payable to the family on the death of a

Investor Daily (3 April 2013), Rachael Micallef

A ruling by the NSW Court of Appeal clarifying definitions around total and permanent disablement (TPD) is a big win for life insurers, according to a leading insurance expert. The Court of Appeal found that a former truck driver - who was unable to work due to injury and retrained as a part-time taxi driver - did not qualify for TPD benefit as retraining was within his existing education. "The ruling has already received a very positive reception from the life industry for two reasons," Lisa Norris, life insurance expert and partner with specialist law firm TurksLegal, told InvestorDaily. "Firstly, it clarifies the issue about reasonable retraining. Secondly, the decision clarifies that an insurer or superannuation trustee can reasonably refuse a TPD benefit when a person is able to work part-time."

<http://www.investordaily.com.au/cps/rde/xchg/id/style/16369.htm?rdeCOQ=SID-0A3D9632-87C716F1>

A big win for life insurers, but ongoing losses

breadwinner. If the breadwinner is disabled and the TPD payments are required for his or her maintenance, there may be inadequate cover should the breadwinner subsequently die.

TPD can however provide too much cover:

- If you are lucky enough to recover fully or partially after you have claimed, you may end up with more money than you need. As TPD will normally pay out after two years, it is not unknown for people to subsequently recover.
- Short term disability income insurance pays out for all types of disability but with a maximum term of two years normally. It leaves a significant gap if you are still disabled after two years. Combining it with TPD insurance still leaves you uncovered for temporary or partial disability after two years.

(ii) Trauma insurance

Trauma insurance pays out when you are diagnosed as suffering from a serious disease. It is expensive, obviously does not cover accidents and some diseases, and is probably not necessary if you have health insurance to cover the medical costs and disability income insurance to cover the loss of income. You can also get involved in wrangling about whether your disease meets the definition in the policy, which can be psychologically destructive. You may well need additional insurance if you contract a serious disease, but it should be offered by health insurers and not as life and disability insurance that is intended to cover loss of income, not additional health expenses.

(iii) Accident benefits

Accident benefits only have value for temporary periods to potential policyholders who are applying for full cover.

“Personal accident” benefits are the worst of gimmicks. They can cover death or disability, and only pay out after an accident. That leaves a huge gap if the death or disability arises from sickness. Accident cover also overlaps with compulsory insurance: most accidents

Trauma Insurance: want to play the lottery? Michael Richardson and Kate Gillmore

Trauma insurance was developed to meet the needs of those who were diagnosed with life threatening conditions. Since its introduction into Australia, however, amendments to the product have turned it into, what some would deem to be a health lottery. ...

No one wants to be told they have ‘The Big C’, but statistics prove that not all cancers are equal. According to figures published by the Cancer Institute of NSW, the five year survival rate for Thyroid cancer is 96.1%, while at the other end of the spectrum it is only 6.4% for cancer of the Pancreas.

It’s a similar story too with brain tumours and prostate cancer, where the five year survival rates are 22.2% and 89.8% respectively. Prostate cancer is the most commonly diagnosed form of any cancer in Australia and one where the industry has significantly changed its stance for trauma benefits in recent years.

Consumers certainly want and deserve protection when the worst happens. However, by paying the same amount for conditions that are likely to have very different outcomes, are we not reinforcing the lottery nature of Trauma Insurance?

<http://www.actuaries.asn.au/Library/AA/2013/Actuaries183S-EP2013.pdf> p 12-14A big win for life insurers, but ongoing losses for their clients?

either happen at work where people are covered by workers' compensation or on the road where people are covered by the Compulsory Third Party insurance.

Accident cover can be a real lottery when benefits are paid according to the "continental scale" of losses: 100% for an arm, leg or eye, down to 15% for the loss of a big toe, and 3% for any other toe. One must wonder whether insurance companies that offer these benefits have realised that in today's knowledge economy, the loss of arms and limbs is far from preventing people from working.

(iv) Funeral policies

While many Australian families are reported under financial stress, and the death of a family member may well create some short-term stresses, the costs of a modest funeral are highly unlikely to reduce any families into poverty.

Those families who are looking for some spreading of the financial costs would invariably be better off by pre-paying the costs with a funeral parlour.

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