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Group Insurance – Structures of the Future

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Abstract

The group superannuation insurance sector of the Australian economy is gifted by the community with compulsion, both from the Superannuation Guarantee contribution which helps finance premiums and from the compulsory Opt Out provisions for members in relation to death and TPD cover.

Over the last 20 years the industry has moved from insuring thousands of small funds whose premium was determined from general industry experience to predominantly a few large and very large funds whose premium is determined by their own experience.

Group death and disability cover provided through superannuation funds, particularly default cover, is one of the most valuable benefits derived by Australians from our superannuation system.

However, the industry in its current form is fundamentally unstable because of the large mismatch risk that the trustees of superannuation funds carry, the very thin, oligopolistic market of suitable alternative insurers and the barriers to entry to the industry and barriers imposed on insurers wanting to compete with incumbent insurers.

Further, the industry has been unable to deliver economies of scale and has a Benefit Efficiency that is low and stagnant. A large component of the premium of large funds is predictably recycled and the friction involved in this process is costly to members.

These factors produce suboptimal outcomes for members of superannuation funds with large swings in premiums, terms and conditions and value for money at levels lower than it should be.

Arguably death and disability benefits are more valuable to members than voluntary retirement benefits as they provide financial support in unexpected circumstances and at a time when members are younger, have lower account balances (and assets generally) and are more likely to have financial dependants. It is also a time of life when social support is less generous particularly in relation to death.

The industry is currently in the process of limiting default premiums by winding back these benefits as the way it envisages addressing the issue of inappropriate erosion of account balances, the assumption being that current structures and approaches are the best available. This paper sets out how better structures could also be used to address this issue for members, retaining benefit levels where appropriate.

This paper explores the Mismatch Risk and Benefit Efficiency and sets out alternative structures that are being used or could be used by trustees to create a more stable and efficient delivery of death and disability benefits for superannuation fund members. The alternative structures meet the APRA benchmark that financial promises are met in all reasonable circumstances.

As always, there is no single optimal solution for all funds.

The paper is focused primarily on the Not For Profit sector as the For Profit sector of the industry predominantly insures, or will inevitably insure, through a related life office and is unlikely to ever change from this structure.

While I take full responsibility for this paper, it is not all my own thinking and has come from discussions with a wide range of actuaries and others in the group insurance and superannuation industry.

Key words: Group Insurance, Superannuation, Benefit Efficiency, Market Efficiency, Mismatch Risk

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1. The Group Insurance Superannuation Industry

The changes in structure discussed in this paper are premised on a number of key observations about the group insurance of superannuation funds. These observations are set out below and explored further in the paper.

1.1. Structure of the Industry

The number of superannuation entities (other than SMSF's) has fallen from 4,747 in June 1996 to 872 in 2006 (APRA 2007) and 219 in 2016 (APRA 2017a). The 219 funds are overseen by only 117 trustee companies (APRA 2017a). The industry has moved from a large number of small corporate not for profit funds to a small number of large for profit and not for profit funds.

Superannuation funds are now very large with most having assets over $1bn. They will only become larger in terms of lives insured as the pressure on the industry to consolidate remains high.

Most but not all cover is supported by a life policy, some trustees being self-insured, and some using general insurance policies for disability cover.

Defined benefit funds are able to self-insure their defined benefits and some do.

Some funds are insured through a related party, most notably those funds which have a bank owned trustee and AMP. QSuper was self-insured until 30 June 2016 and set up a life licence and life company so it could continue to self-insure.

In the 1990's there were around 12 group insurers each with similar market share. The insurer market has consolidated and is now an oligopoly.

Despite the dramatic changes in the superannuation industry, the basic insurance structures in superannuation are unchanged:

- single insurer, insuring all of the claims cost;
- possibly supported by a single reinsurer; and
- claims determined by the insurer with oversight from the trustee.

Death and disability cover, which traditionally must be sold because it is not bought by consumers, is predominantly default cover set up by trustees for their members. It has been a successful method of overcoming this consumer inertia.

1.2. Is the Industry Efficient?

Efficiency can be viewed in terms of market or competitive efficiency.

It can also be viewed as the proportion of the premium that is paid as claims or returned to members in some other way. I have termed this Benefit Efficiency, adopting similar concepts to that of the CIPR proposals.

Market Efficiency

Market efficiency can be defined as a market that has:

- many willing buyers;
- many willing sellers;
- a readily discoverable long term price; and
- no major barriers to entry, e.g. tax, cost of tendering, data and information availability, or exit.

The industry arguably met this definition in the 1990's when there were a large number of funds and insurers. This contrasts this with the current market which is an oligopoly on the supply side and on the demand side the number of funds has fallen and will continue to fall.

Superannuation is an industry still in consolidation phase and is likely to see fewer larger (lives covered if not premium) funds in the future.

For insurers, the barriers to entry are large. They include:

- tax advantages to incumbent insurers in the stamp duty regime;
- tax advantages to life insurers over general insurers in the GST regime;
- high costs and lag times establishing a life office and obtaining a licence;
- prohibitive costs and consumption of management and board time if tendering for new business;
- Very uneven playing field where the incumbent has much better access to data, and time to absorb and understand it when determining future prices, terms and conditions;
- An industry that has been unable to wean itself off the winner takes all approach to insurance;
- Most of the group superannuation premium sits with very large funds; and
- Smaller policies are most likely short term and therefore of lower economic value to the insurer as APRA pushes for smaller funds to merge.

Despite the above, contractual terms are short term and there is little incentive to provide a fully tailored arrangement.
Trustees are faced with the likelihood that insurance will never be provided through an efficient life insurance market.

Trustees will receive no assistance from APRA in driving improvements in market efficiency. APRA's focus is on consolidation with fewer participants and on stability over efficiency and competitiveness. Regulatory and other barriers to entry will remain high.

Looking at reinsurance, the picture is quite different. Part of the reason for this is that the primary service provided by the reinsurer is capital. Large capital and ongoing expenditure is not required for claims management, technology and systems. Overseas reinsurers provide diversification benefits and also a very good alternative to what was a very thin reinsurance market in Australia. Some insurers also provide reinsurance support.

The reinsurance market has moved away from its oligopolistic structure of a few years ago and there are signs its stable state may be one providing healthy competition.

Benefit Efficiency

Benefit Efficiency is a term used in this paper and extends the concept of Income Efficiency introduced by the FSI (Financial System inquiry, 2014) and taken up by Treasury in its 2016 CIPR paper (Treasury, 2016). Income efficiency is defined as the present value of income in retirement as a percentage of a product's purchase price. So, what proportion of the purchase price is returned as income to the member after leakage from administration costs, capital costs and bequests.

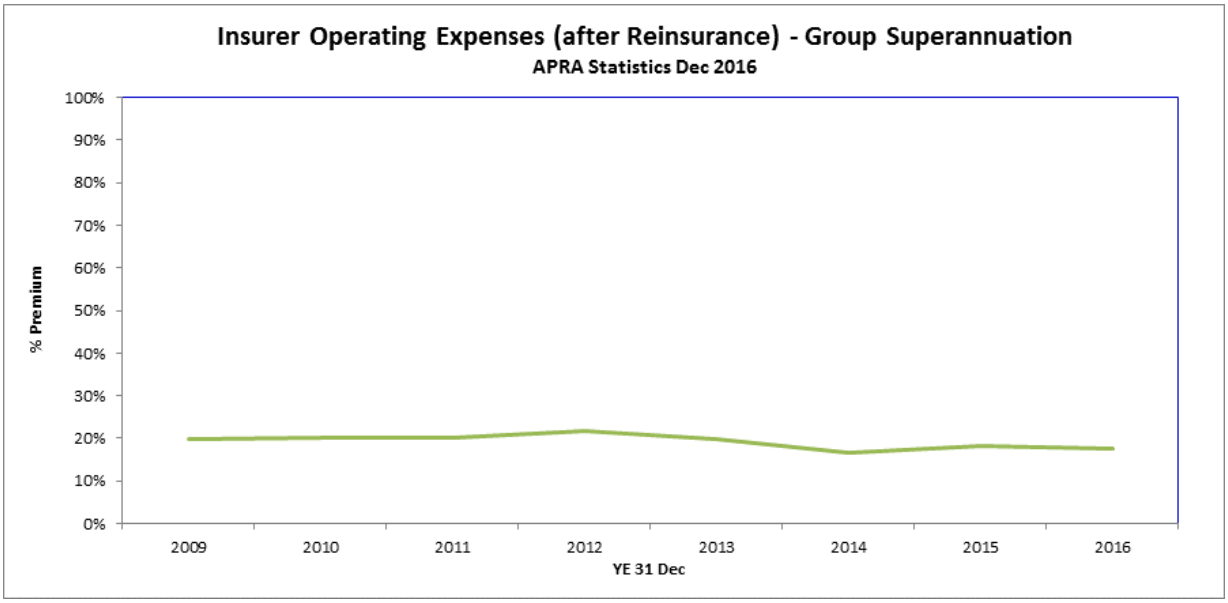
Benefit Efficiency in the context of this paper is the proportion of premium that is paid back to members as claims and rebates, after 'leakage' from administration costs, capital costs including investment earnings and stamp duty taxes.

In 2016, insurers incurred claim costs of around $4.1bn for death and disability cover provided to superannuation funds (APRA, 2017b) net of reinsurance. These APRA statistics are deficient as they do not report claims cost consistently with the premiums that generated the claims costs. Nevertheless, a lot of financial support is going into the Australian community, generally at a time of financial need for the individuals ultimately receiving payment.

Superannuation funds paid $5.3bn in premium (and $0.3bn in investment returns) net of reinsurance in 2016. $1.5bn went to profit, expenses and stamp duty (APRA, 2017b). So, Benefit Efficiency was 73%. For a group product, this performance appears poor.

Most large not for profit superannuation funds provide higher Benefit Efficiency than shown in the industry wide numbers as would be expected given their purpose and size.

The operational costs for insurers for group business are stuck at around 20% of premium despite a premium increase over the last 7 years of 126%. While there have been improvements to service which do have to be paid for, many of these are technological and should by now be delivering reductions in the cost base.



The small drop in the level of expenses from 2013 to 2015 can be attributed to the removal of commission from group insurance in superannuation.

Looking forward, the amount of compliance and regulation continues to increase not only from APRA and ASIC but the industry itself e.g. ISWG is issuing "an enforceable Code of Practice and Good Practice Guidance for Trustees" (ISWG, 2017), potentially creating another set of implementation, monitoring, legal and policing costs on the industry and members. It is not clear that comprehensive cost-benefit analysis is provided with each set of additional compliance requirements. Rather these are a reaction to media and political pressure and will be aimed at relieving this pressure.

Conclusions

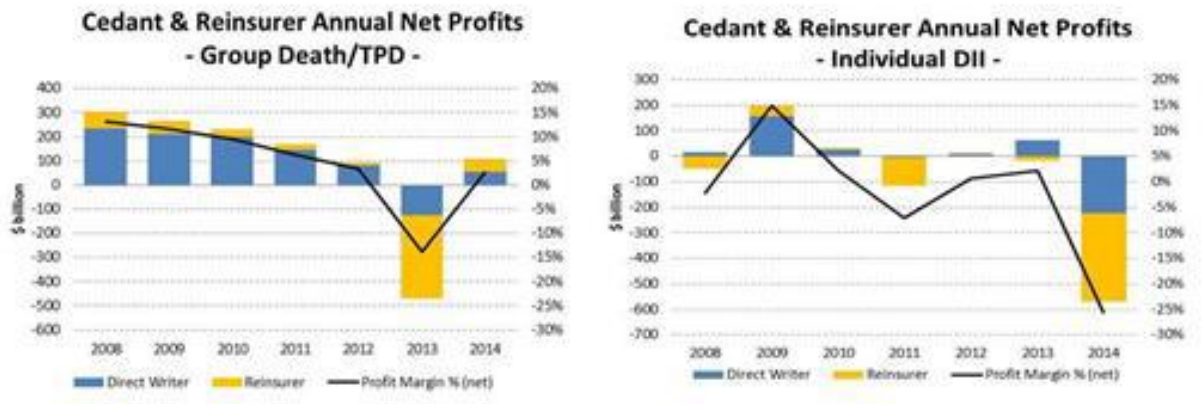
On these two important criteria the industry is not efficient, with the only bright spot being the reinsurance market.

Market efficiency will never return at the insurer level.

There is room for Benefit Efficiency to be improved significantly.

1.3. Recent Experience

The group life industry has recently experienced a large destabilising cycle in claims experience, represented well by the graph below, on the left (Laughlin, 2015).



The graph shows the three key features of the experience:

a) A sudden fall in profitability;

b) The hit was taken disproportionately by reinsurers; and

c) The recovery was as quick as the fall, again disproportionately to reinsurers, perhaps due to better terms but also perhaps because of a degree of over-reserving.

Experience has continued to improve (see graph Section 1.8)

The market became dysfunctional in 2013. How dysfunctional? It serves us well to remember how low things can go in such a short period of time and the extent of the withdrawal of support that trustees experienced. Looking at a sample of six industry fund tenders conducted at the time, the response from insurers was:

- 1 had only the incumbent quoting without reinsurance support (two insurers who were keen fell away through lack of any reinsurer support);

- 2 had only the incumbent quoting;
- 1 had the incumbent and one other insurer (but only for disability cover); and
- 2 had the incumbent and one other insurer.

In all cases the incumbent retained the business.

The lack of a functional market over 2013, 2014 and 2015 saw excessive premium increases for a number of funds. These increases are now being unwound but have damaged the credibility of the group market. This is recognised by some people in the industry e.g. Leigh Watson expressing his thoughts on the Swiss Re website in 2016 (my bold):

"The recent industry Group risk crisis showed us how underpricing can create dislocation with dramatic impacts on affordability and continuity of cover. **Overpricing is equally, if not more, disruptive and inequitable**. As an industry we should seek to set sustainable prices which are affordable long term, deliver fair claim outcomes and yet include appropriate profit margins for insurers. The industry needs to make profits in order to reward those who put their capital at risk and also to generate reinvestment. An unprofitable life industry is no good to anyone but too much profit will not deliver the right customer outcomes over time."

This balanced position is aligned with the position of most funds and the industry has certainly matured through a crisis which has resulted in some very positive changes.

The shortening of guarantees has for many funds shortened the relationship with their insurer and has imposed a large additional cost base on the industry. On the positive side, it allows premiums to be adjusted more quickly which is good for all parties where the adjustments are appropriate.

This period also saw some funds lapse cover (Humphreys J, 2016) as trustees determined their members were not being treated reasonably and the premium rates offered by the industry failed the inappropriate erosion covenant in the legislation (SIS, 1993):

"….to only offer or acquire insurance of a particular kind, or at a particular level, if the cost of the insurance does not inappropriately erode the retirement income of beneficiaries".

It is highly likely that the cycles in life insurance will continue and that the disparity between insurers' experience and reinsurers' experience will continue albeit for different reasons.

There is also a high probability of market failure sometime in the future as there was in 2013 and 2014 with the sudden unexpected withdrawal of support by the life industry for benefits provided by large funds to their members.

1.4. Nature of the Trustee Commitment

Trustees make long term commitments to their members in relation to the provision of death and disability cover at fair prices. This cover is very difficult to remove because of superannuation and consumer laws and the effect this would have on the Fund's credibility and therefore sustainability.

Trustees are unable to match these long-term commitments through the life insurance industry which provides only short term guarantees on premiums, terms and conditions and as was seen over 2013 to 2015 short term commitments to supporting the industry. The "guaranteed renewable" feature of a life policy is meaningless without constraint on how high the premiums can be set or how poor the terms and conditions can be set.

I refer to this disparity between the long-term commitment of funds and the short-term commitment of the life industry to those commitments as the trustee's Mismatch Risk.

Funds carry the Mismatch Risk, one that impacted their credibility and their members in 2013, 2014 and 2015 when the market failed badly and one that is likely at some time to emerge again.

1.5. Retrospective Pricing

This Mismatch Risk is accentuated if an insurer is appointed who retains the right to retrospective pricing under the Contracts Act.

This is a dangerous extension of the Mismatch Risk for the trustee.

Insurers who insist on this type of clause in their policy are signalling their lack of experience or willingness to understand the fund and its design and data. These insurers should be avoided by trustees. The real risk here for the trustee is that all data is uncertain and less than perfect and the trustee is exposed to an insurer manufacturing a dispute, if the insurer makes a mistake or experience deteriorates, as a way of mitigating their loss or potential loss relative to the profit expected. This is a real risk and has impacted at least one fund.

Some insurers attempt to include this clause even when they have been the insurer for several years and want the right to retrospectively change price even if their own claims data is incorrect.

A similar issue may arise for an insurer appointing a reinsurer.

1.6. Is it "real" insurance?

Insurance is a "risk-transfer mechanism that ensures full or partial financial compensation for the loss or damage caused by event(s) beyond the control of the insured party" (Business Dictionary).

The insured party is the trustee in the case of group death and disability insurance of superannuation funds. It is not the individual member.

For large funds, only a small proportion of the premium involves genuine risk transfer from the trustee to the insurer. The majority of premium is returned to the trustee as claim payments and in some cases, rebates each year in a very predictable manner. The real risk premium for large funds is in relation to the claims tail, a small stop loss risk which accounts for 5% to 15% of what we would traditionally refer to as the risk premium.

Most large funds have a rebate mechanism for better than expected claims experience. For these funds the life policy is in effect stop loss cover. For those funds without a rebate, with some rare exceptions, the life policy is expensive stop loss cover with the added cost of releasing all the better than expected claims experience to the insurer.

For large funds, which dominate the group insurance premium, a very large part of the premium is simply money recycling.

This contrasts with small funds such as those that dominated the industry in the 1990's. For these funds, the whole of the risk premium is a risk transfer. The number of expected claims is statistically small with very high variations year on year.

Despite the change in the nature of funds, large funds continue with structures far more appropriate to the past.

There is a rule of thumb in relation to insurance that applies to all consumers, large and small:

You should only insure what you cannot afford to replace.

There is good reason for this rule. Paying premium where there is no risk transfer is costly. It involves money recycling which is costly not only because it has to be managed and accounted for but also because it attracts unnecessary tax (stamp duty and for general insurance companies GST). This is referred to as friction. It is not possible to have frictionless money recycling.

For group insurance there is another loss and that is the cost of a lack of focus on expenses which are readily hidden and are swamped when viewed as a proportion of the premium.

It is reasonable to believe this is part of the reason Benefit Efficiency is poor for group insurance.

1.7. The nexus of member premium and insurer premium

The premium paid by the member to the trustee does not have to, and in most large funds does not, equal the premium paid by the trustee to the fund. This may be because of an administrative charge imposed by the fund for its costs

of providing death and disability benefits or a premium smoothing process managed by the fund or both.

1.8. Are Large Funds Self Insured - Claims today are premium tomorrow

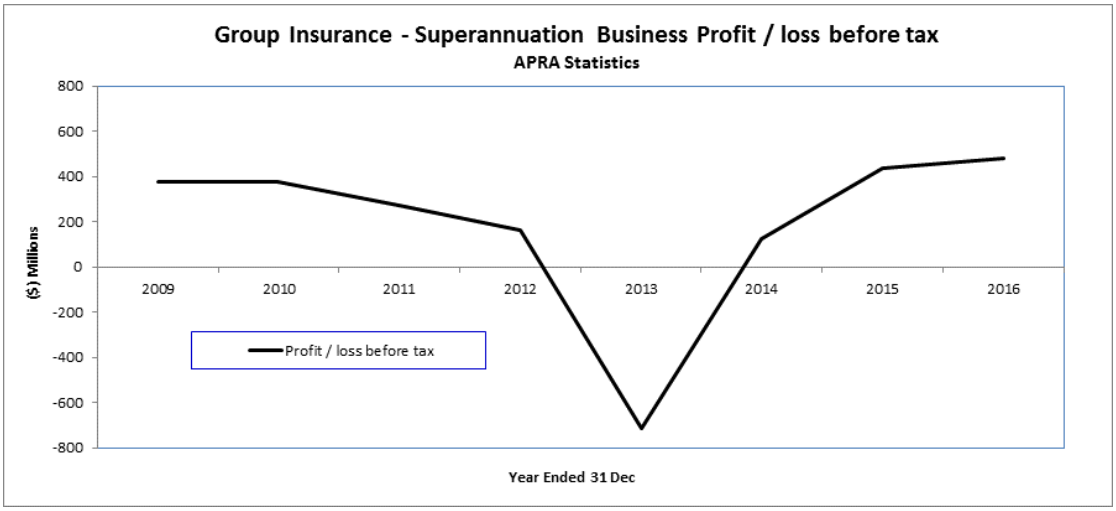
Self-insurance occurs when the consumer meets the cost of their own claims.

Large funds are arguably self-insured. This is a key proposition of my paper.

For large funds medium and long term premium is determined to a large extent by the fund's own experience. There is no pooling of the experience with other funds when determining premium rates.

With short term premium reviews, large barriers to entry and the intertwining of fund and insurer in relation to systems and processes and the major upheaval that a change of insurer involves, large funds cannot change insurers quickly and insurers are able to claw back losses. In these circumstance funds are self-insured in the short term.

No better illustration (see graph below) of this can be found than the reversal of the 2013 losses incurred by insurers which lasted just 1 year and was replaced with higher than expected profit and a return on capital higher than other sectors of the economy including those sectors that carry far more risk for their shareholders.



(APRA 2017b)

Worryingly for trustees there is a practice now by insurers of passing on adverse experience "trends" into future pricing. With few exceptions, past loss ratios that are higher in more recent years than prior years are interpreted as definite indications of a trend, rather than claims fluctuation, and without explanation of underlying cause of the trend or why it may persist into the future. Further, the trend is inevitably linear, again without explanation. In almost all cases where a trend has been embedded in the future price, the experience shows that it was not justified and as experience unfolds for those periods, the trend

disappears. See the example shown in the 2016 Insights Session (Humphreys J, 2016).

The ability of insurers to simply pass on "trends" into pricing means that there is a diminution of the normal pressure on life offices to manage claims or improve claims processes. Poor claims management will create an upward claims trend which will be easily put through the pricing process.

There is also a danger in these circumstances (and with the lowering of benefit levels recently and possibly in the future) that the cost of assessment may approach or exceed the sum insured retained by the insurer. It is then in the financial interest of the insurer to admit a claim at the expense of the trustee and possibly the reinsurer.

Return to work strategies have been introduced by the life industry at a snail's pace. We have known for over two decades that early intervention reduces claims cost and improves outcomes for members (Humphreys J, 2014). Yet in 2016 the average time from the date an IP claim is reported to the insurer to the date an in-house Rehabilitation Consultant first sees the file is 123 days (Swiss Re, 2016). The Return on Investment metric (Swiss Re, 2016) is still very high and indicates not enough effort is being made in this area.

Again, is this a reflection of who is paying? The push to better and more comprehensive return to work claims assessment is from the fund side of the industry, not the insurer side.

In summary, large funds can be viewed as self-insured with some level of short term stop loss cover, self-insured in the medium and long term and generally in the short term; if you like informally self-insured.

1.9. Who can provide the key services currently delivered by a life policy?

The key services provided by a life policy include claims management, services to members, services to the trustee and capital – see Attachment A. For large funds, there is no reason why these services must only be provided by a life office and they at times are not:

- Large funds with their long-term commitments to members carry the majority of the risk of poor claims experience which impacts on their future premiums. They therefore have more "skin in the game" in relation to claims management than insurers (see Section 2). Arguably they should take more control of the process and decisions.

- Funds are trusts whose only purpose is to act in its members' best interests. This includes in relation to the level of premium rates and claims management. A superannuation trust has a fundamentally different culture and outlook to one set up to derive profit. Claims management looked at holistically as provided to date by insurers does not reflect the philosophy of a trust fund. The life insurance industry has been slow moving to an empathetic and efficient claims management process

that reflects trustee culture. It is not certain that the transition will ever fully occur.

- Large funds have the ability to make the investment decision to support their commitments to provide death and disability benefits, either by setting up a life office or self-insuring. They have the investment expertise and processes already set up and capable of determining whether or not the return and the risk profile of the investment is suitable for the fund. Indeed, they are well placed to meet the APRA's own benchmark (APRA Mission) to ensure financial promises are met "under all reasonable circumstances".

- Large funds can access reinsurance support, including catastrophe cover and some already do this.

- Large funds have the resources or can establish the resources required to undertake any or all of the services provided by a life policy.

- Funds who formally self-insure and self-administer the death and disability benefit do so effectively, across capital, reinsurance and claims management.

1.10. Other Industries – General Insurance

It is informative to consider how other industries are structured.

Looking at general insurance, we see a very different structural picture to group life insurance offered to large funds:

- For many lines of business there is market efficiency.

- Policies are often carried by multiple insurers rather than a single insurer.

- Companies are able to self-insure their statutory disability benefits (Workers' Compensation) without having to set up an insurer. For example, in NSW 57 entities (not all are companies) are self-insured (SIRA). These companies have a wide range of credit rating – see Attachment B.

- Companies are able to insure with an overseas insurer or a captive.

- The claims variability is much higher than for a large superannuation fund as even the largest employers have significantly fewer insured lives.

It is informative to contrast the situation of large funds providing IP and TPD benefits with companies who must provide Workers Compensation, All the benefits are disability benefits and cover predominantly the same lives, working Australians. The State Insurance Regulatory Authority and community clearly believes that allowing companies to self-insure is a reasonable risk for the benefit of a higher level of market efficiency and Benefit Efficiency.

2. Claims Management

2.1. Introduction

Arguably the most important function provided to the members is claims management. This not only impacts the quality of life and financial circumstances of claimants but also the claims experience and for all members impacts the premium rates.

Current claims practice revolves around the trustee (in the form of the administrator) collating information and then sending the information to the insurer. The insurer decides whether or not a claim should be assessed and ultimately paid or declined.

While some funds have tried to streamline the process, generally current practice results in unnecessary delay for members through the interaction of two distinct parties. Add to this the necessary trustee oversight of declined claims and the process is less than optimal for the members.

Large funds require large claims teams within the insurer trained in the specific design and requirements of the fund under traditional structures. The insurer must set up and maintain these teams. For the trustee, a change of insurer will be very disruptive as a new team and training will be required. A similar situation applies to process and systems. This is not only inefficient, it creates another barrier to entry and an economically inefficient market.

2.2. Death and Terminal Illness claims management

There is no management function for these claims. There is an administrative process that involves no specialist skills or knowledge and certainly no claims management.

It is unclear why these claims are passed on to insurers to "assess". The added layer of work simply increases the premium paid and results in a slower process for the beneficiaries, and for terminal illness, the member.

2.3. Disability claims management

For large funds, the trustee has more to lose from poor disability claims management than the insurer.

Current structures allow insurers to pass higher claims cost resulting from poor claims management to the trustee. Further, a trustee with a deteriorating claims experience due to poor claims management is exposed to what can be termed the "Trend". The Trend is the actuarial practice of linear projection of past loss ratios to determine future pricing, but only when past loss ratios are increasing. Insurers adopting this approach have no financial incentive to improve claims management. Further, with the standardisation of actuarial practice and APRA's guidance, the insurer knows that other insurers will price similarly.

For the trustee, poor claims management means:

- the IP claimant is most likely worse off as they will return to work later, if at all, and the trustee will not have fulfilled its obligations to the claimant;
- The claimant may develop secondary disablement conditions such as mental health issues;
- Members are worse off as their premium is higher than it would otherwise be. The trustee may also be forced to reduce benefits if the premium is determined by the trustee to be inappropriately eroding the account balance. This is exacerbated If members who could have returned to work do not do so as a TPD benefit will most likely be payable; and
- There is the possibility that other funds will become more attractive and there will be a loss of existing and/or new members.

2.4. Claims philosophy

While trustees are required to ensure that the insurers claims philosophy is appropriate, in practice this is very difficult to achieve. Claims assessors are generally not segregated from their employer or the employers' culture. A trustee trying to embed the fund's claims philosophy will find it hard to superimpose this on to the staff of an insurer where the focus and culture may be different.

The lack of progress in relation to claims management, discussed in Section 1.8., points to the difficulties here.

2.5. Better claims structures

Better structures involve the trustee taking control of claims management with the insurer and reinsurer(s) having the right of audit. The insurers may also add value through technical training and quality control. This can be achieved by:

- embedding the insurer's staff within the trustee's administration function; or
- the trustee employing the claims management staff directly.

The trustee having control of its claims team allows it to embed the fund's culture and claims philosophy in the team. It provides far more continuity of process, systems and understanding. It allows long term investment in these processes and systems, a feature missing in the current structure with short term guarantees. It allows quicker change when it is needed. Very importantly it provides direct oversight and continuity in the quality of staff and their training.

It also removes one of the barriers to a change of insurer as this will not involve a period of discontinuity with claims assessment and management.

It allows integration with the trustee's administrator improving service to members and reducing duplication and costs.

A number of funds have moved down this path. In the case of QSuper it continued its self-insured approach to death and disability benefits in part because the insurance industry could not deliver on the claims management and service levels it provided and wanted to continue to provide to members (Staunton G 2016).

3. Alternatives Structures

The future is already here — it's just not very evenly distributed (Gibson W, 1993)

The following sections discuss the alternative structures that may improve the delivery of death and disability benefits to members. As the quote above suggests, most of these are already in place in one form or another. In some cases, they are modifications of how current group insurance structures work. In other cases, they are modifications of the approach of other sectors of the economy.

Each structure meets the APRA Benchmark of meeting financial promises in all reasonable circumstances (APRA Mission).

Improved delivery of benefits may come from:

- reducing the risks faced by trustees and ultimately members;
- reducing volatility in premiums;
- increasing efficiency which will reduce premiums; and/or
- improving the so called "member experience".

The alternative structures discussed are:

a) Alternatives that modify current structures
   - Multiple reinsurers;
   - Premium Adjustment models;
   - Agreed Margin models;
   - Stop Loss Cover;
   - Separate Statutory fund; and
   - Life licence;

b) Alternatives that introduce structures not currently used
   - Derivatives;
   - Self-insurance; and
   - Pooling.

Attachment D summarises the structures against a set of attributes that a trustee may look to for guidance on the alternatives.

There is no single best solution. It depends on fund priorities, the relationship and commitments made in current contracts, size, performance of the current arrangement across the key areas. However, it does become clear that as funds become very large taking more ownership and responsibility for these benefits will improve both efficiency and stability for members.

4. Alternatives that modify current structures

4.1. Multiple reinsurers

The current culture of the group life industry is to retain all the risk or if it is shared it is shared with only one reinsurer. Insurers are reluctant to give competitors the right of audit even if it is only in relation to the one client. This makes it harder for other companies to understand their processes and technology and other differentiating features of their product.

On the other hand there are disadvantages for all parties:

- For the trustee, the exposure to the Mismatch Risk is high particularly if another claims crisis was to arise. Further, the trustee's experience is understood in depth by only one insurer and one reinsurer perpetuating a barrier to a fairer market.

- For the insurer, there is a concentration risk not only in relation to particular sectors of the economy but also to their business being reliant on the continuation of large policies. At the very least, if a large policy terminates there is significant disruption to the insurer's business.

- The reinsurer carries a similar risk to the insurer. However, the disruptive effects will be lower.

Risk sharing in the general insurance sector is common and works well for insurers. How could it happen in the group risk market? Risk sharing will require a change of culture for insurers and this may require funds to take a more active role in promoting risk sharing.

There are a few methods that could be considered:

a) Risk swap between insurers, like a barter system or as a premium at the reinsurance rate. This has risk diversification advantages for the insurance industry. Is it better to have 100% exposure to the construction industry or 50% exposure to construction and 50% to schools? It could only be undertaken where insurers have faith in current pricing of the incumbent and the reinsurer. The fact there is a risk swap protects insurers from the audit risk as both insurers will be able to audit on the policies swapped.

b) Recognising the significant cost in terms of resources and money that insurers and reinsurers put into a tender, unsuccessful insurers who have made a genuine response would be offered an option of a small share of the risk at the reinsurance rate;

c) Another alternative is for the fund to run a reinsurance tender to the full market of reinsurers and insurers other than the incumbent who would retain the role of insurer and a portion of the risk. This has the advantage of keeping current processes and infrastructure in place while testing the

incumbent's pricing, terms and conditions and diversifying the fund's exposure to a single reinsurer.

d) This could be extended so that the insurer receives an agreed margin above the reinsurance rate established under c), with the option for the insurer to decline this and instead participate in a full tender for the policy.

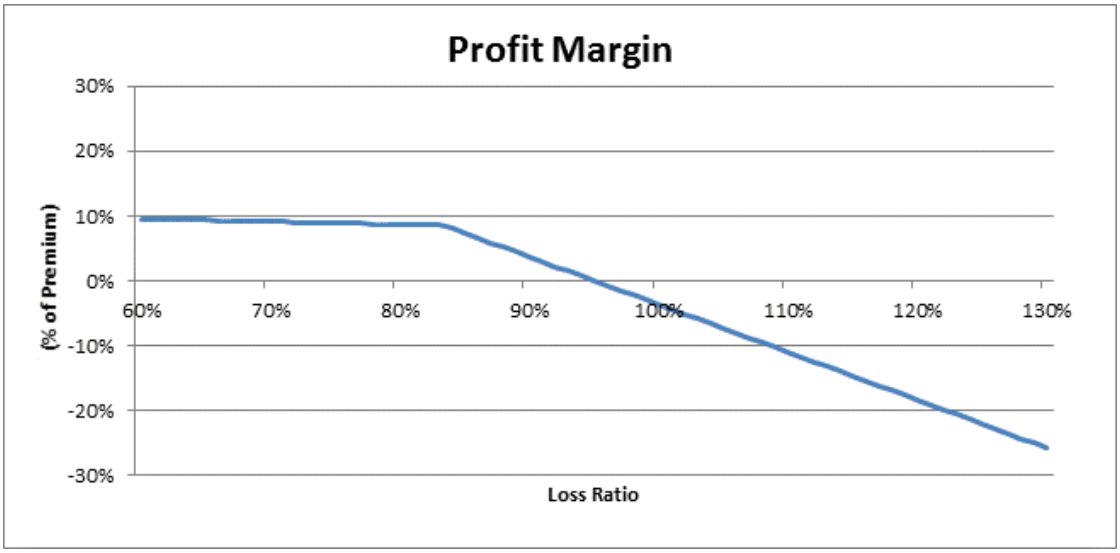
e) Extend the reinsurance tender to include suitably qualified overseas reinsurers. For the fund this brings the advantage of additional capital to the market and also reduces the exposure to a homogenous approach to pricing in the Australian market, particularly as we saw in the recent claims crisis. Suitable overseas reinsurers may also have a longer-term view of variability of returns and lower shareholder hurdle rates that are more aligned with risk and a fair equity premium.

4.2. Premium Adjustment models

Traditionally this means a rebate mechanism is put in place where a proportion of up to 100% of any better than expected claims experience is returned to the fund. The experience may be measured over 1, 2 or 3 years.

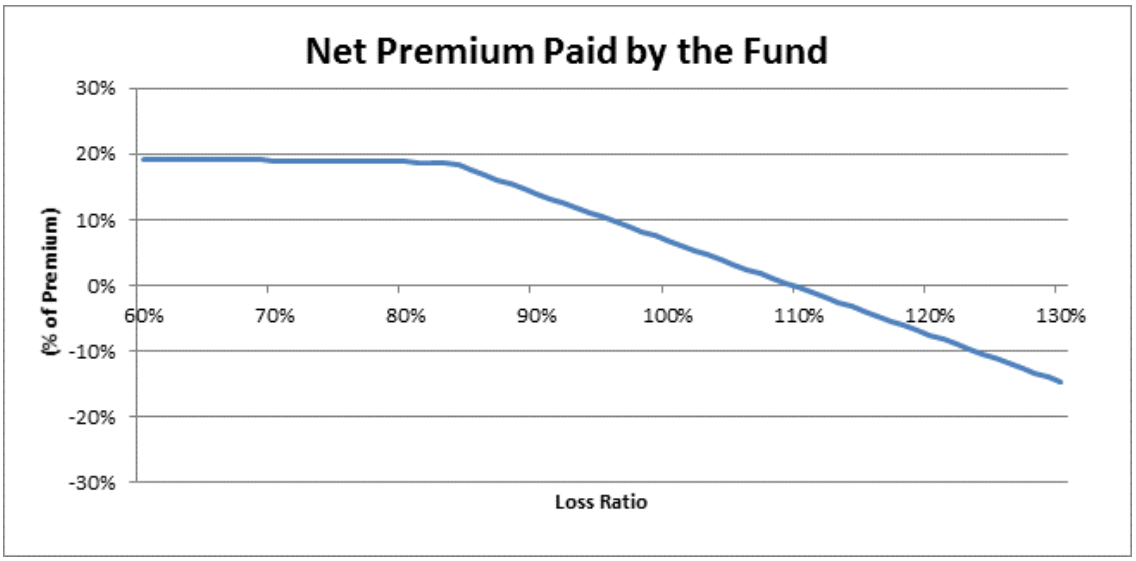
Mathematically these structures are an option, exercised by the fund if claims experience is poorer than expected. They effectively provide the fund with stop loss cover. Because the full premium rather than the stop loss premium is paid, the insurer receives an additional margin through the investment return on the claims reserves.

A typical profit margin profile would look like the graph below where 100% of better than expected experience is returned to the fund. I have set the expected loss ratio at 72% in this example. The profit margin is the value of profits divided by the value of premiums.



The insurer has a steady income stream until claims exceed expected levels by around 20%. The profit margin falls to nil if claims exceed premiums by more than around 30%.

The profile of the premium paid by the fund net of the value of claims and rebate is shown in the graph below.



In years where claims are less than 120% of expected claims, the net premium is around 20% of the gross premium. This falls to nil when claims are at around 150% of expected claims cost.

The fund applies rebate amounts to reduce future premiums, improve benefits or improve death and disability benefit processes and technology.

Some funds have moved this concept further, committing to pay additional premium in the case of claims experience that is less favourable than expected. The fund manages this commitment through its insurance reserve. The commitment provides an additional buffer for the insurer, reducing its capital requirement and therefore the loading for cost of capital. The reduction is broadly of the order of 50% for a 10% additional premium commitment from the trustee.

The advantages of the premium adjustment models are:

a) Trustee management of the member premium;

b) Fair ultimate premium is paid by members at least for those who stay insured in the fund;

c) Suits a partnership approach between fund and insurer;

d) Suits a fund that wants to provide innovative designs that do not have past experience to support them as the insurer will have a natural

additional buffer of protection that is paid back to the trustee if not needed;

e) At times of capital shortage amongst insurers, the capital change in the premium should remain lower.

The disadvantages are:

a) setting up the processes and systems;

b) additional actuarial and management oversight; and

c) not all insurers are comfortable giving up super profits in exchange for the additional buffer and more certain but potentially lower profit flows.

4.3. Agreed Margin models - transparency

These models involve the trustee and insurer agreeing the proportion of the premium that will be allocated as the insurer margin. The model requires transparency on the part of the insurer in relation to its expenses, capital, cost of capital and cost of reinsurance arrangements. Typically stamp duty would be a straight through payment.

Annual adjustments are made for actual stamp duty and for dollar expenses e.g. increased with AWOTE.

These models take a lot of the tension out of future pricing discussions and increase trust between the parties allowing the parties to concentrate on the expected claims experience. They add a high level of trust as the fund can assume it is being treated fairly in relation to the insurer's margins.

These arrangements substantially improve the relationship between insurer and trustee. They allow the trustee to determine the value for money it receives in relation to these margins, if you like where their premium is being spent for the benefit of members.

The arrangements add a layer of equality in the relationship so that premium increases or reductions in relation to claims do not impact on the appropriateness of the insurer margin.

4.4. Stop Loss Cover - only insure what you can't afford to replace

For the trustee of a large fund most of the premium flows back each year as claims and, for those with a premium adjustment mechanism, rebate. The premium represents very little in the way of risk transfer and therefore fails this basic test for the need to have insurance.

Looked at another way, the trustee as the insured party can include a very high excess in its policy.

Nothing on earth is frictionless and this is true for money. Money that is recycled is returned at less than 100%. It is inefficient. In the case of group insurance. It is diminished through the costs of processing and administering it, overheads and taxes.

In addition, excess premium leads to inefficiency as margins are compared with the premium and on this view, may appear small and inconsequential. Excess administration loadings in the premium of $1m quickly become insignificant if the annual premium is say $200m and typically are let through.

Large funds should consider getting back to the core risk transfer when considering their insurance structure. The payment of the stop loss premium or if you like applying a suitable excess for their policy will create better efficiency and lower premiums for members.

Section 4.2 showed that stop loss arrangements are already common in the market, they are just clunky. Current premium adjustment models effectively provide stop loss cover but with high margins and a large investment income flow to the insurer. This section also demonstrates that stop loss cover would not be self-insurance when the excess is pitched at the correct level.

Stripping out the inherent inefficiency in the large predictable flows of money from fund to insurer and back again is intuitively attractive. It provides a better focus on the margins in the premium for expenses. It significantly reduces the taxation burden on members particularly for disability cover.

Of course, the trustee will still require and pay for the key services of a life policy, including claims management. What the lower premium will do is bring a better focus on the expense loading and what constitutes this loading in the premium as it will represent a significant margin on top of the stop loss premium.

The stop loss premium should be around 5% to 10% of the premium depending on the cover types included and the details of the arrangement. It will be lower where the trustee maintains a healthy insurance reserve. An additional loading for the current investment earnings margin that insurers receive may be required but this is not large with current low interest rates.

With risk premiums at these levels the expense loading will be around 50% of the premium rather than 5%. At this level there will be a much better focus on improved processes to drive this down.

A stop loss arrangement would combine well with the Agreed Margin Model, Section 4.3.

4.5. Separate Statutory Fund

For larger funds it would be possible to have a separate Statutory Fund for their policies only. This would allow the fund to provide capital to the Statutory Fund and share in the profits generated by the Statutory Fund.

This arrangement would require the buy in from investment division of the fund and a cultural shift in the group risk market which may take time. It also requires an insurer with a transparent approach to expenses and expense allocation.

The major advantages with this approach are:

- It reduces the Mismatch Risk as the fund is able to fill capital shortfalls in a market failure;
- It should allow the trustee to provide lower premium rates to members as the fund's hurdle rate is lower than the shareholder hurdle rate of life insurers;
- It gives continuity for the insurer and the potential for a longer term relationship with an agreed exit strategy that is suitable for both parties and more certain than the current tender process;
- The fund shares in the operational and investment profits as well as claims experience profits (that can be obtained through a rebate mechanism) and of course losses. This provides a much closer alignment of interest between insurer and fund;
- it provides a diversification and return benefit to the fund's asset portfolio;
- It allows a relatively simple and clean transition should the fund want to obtain its own life licence as the Statutory Fund could be transferred to the fund's life office. It removes the legacy issues associated with terminated policies; and
- It allows the development of other life products specifically for the fund membership such as annuities and other longevity products.

4.6. Life Licence

Many funds are insured or predominantly insured by a related party life office. This is the approach taken by for example the trustee of the superannuation funds run by ANZ, AMP and CBA. It is also the approach taken quite recently by QSuper.

QSuper is the first large not for profit fund to go down this path for accumulation members. It made a well thought through strategic move to put in place a "Plan B" should the insurance market fail to meet its requirements. At the time this risk was high.

QSuper ran an insurance tender and was able to include the alternative of QInsure (QSuper's life office concept) as a third insurer. QInsure had good reinsurer support (quota share and catastrophe cover). The tender allowed QSuper to compare and contrast the three alternatives. The process and the results of the tender were documented in detail in an Insights Session in 2016

(Staunton G, 2016). The trustee rated the three insurers using standard tender rating criteria. The results shown in the Insights Session were:

Assessment Criteria	QInsure	Ins 1	Ins 2
Risk assessment – capital ratio, takeover terms and client conflicts	✓		
Product features and conditions	✓		
Proposed service approach			✓
Underwriting Management capability		✓	✓
Claims Management capability	✓		
Pricing and associated terms	✓		
OVERALL ASSESSMENT	✓		

Of note is the claims management function where the industry could not match the processes and claims philosophy of the trustee. This highlights the points made in Section 2.

It is open to any party to apply for an Australian life licence. I have summarised below the key aspects of this approach.

Process

The process to have a (limited purpose) life office operational is lengthy but straightforward. The process can be viewed under three major headings:

- Setup Stage 1 - Business Case and Board approval to proceed with setup. This includes determining (and being able to demonstrate to APRA) that this course of action is consistent with superannuation legislation and in particular that the fund is acting in members' best interests;

- Setup Stage 2 – Set up the life office to the point it is operational; and

- Obtaining the life Licence – APRA. APRA must register a company unless it is satisfied there are grounds for refusal. These are listed in the legislation and are sufficiently broad and vague to allow APRA full discretion. It is important to involve APRA from the very early stages of the process including making them aware (through the fund's current contact point) that the Trustee is considering the issue.

A period of 12 months is suggested from the date the Trustee resolves to set up the life office to the date the life office is operational.

Prior to this a period of 6 moths is suggested for the Business Case (initial case and detailed case) and Board approval to proceed.

There are resource commitments required to setup the life office specifically in the following areas:

- Actuarial particularly in relation to the Appointed Actuary work;
- Board, management and staff recruitment;
- Legal / compliance;
- End to end processes including systems and IT;
- Investment;
- Reinsurance support including quota share and catastrophe cover and assistance with service delivery and claims management; and
- Structural.

Some of these resources can be (and in some cases may have to be) obtained externally. However, in general where internal staff, particularly those who will ultimately work for the life office, can be found/seconded/employed then this is preferable.

Investment

The life office will be an asset of the fund (presumably part of the private equity sector). As such it should go through the fund's investment selection and criteria process to the extent the fund assets are required to fund the setup costs and the ongoing capital requirements of the life office.

Uses

There are a range of uses for the life office once it is set up. The life office could operate as insurer or reinsurer.

There is also the opportunity to extend the product range to annuity or other longevity insurance products which has many advantages for the fund and the life office, particularly as this will be focus for the superannuation industry in the short and medium term.

Consideration is required of the optimal arrangement from a short term and longer term perspective.

Advantages and Disadvantages

The advantages and disadvantages set out below are expressed in terms of acting in members' best interests. This test is applied assuming there is no limit to Trustee time and resources.

In practice, other areas of change or activity in the trustee's operations could equally meet the same test. The resolution of this conflict and demand for the limited time and resources of the trustee is determined by the trustee.

In many cases the advantage or disadvantage is not definitive and the Business Case process will determine this more accurately.

The advantages and disadvantages are discussed in relation to the life office option. The advantages and disadvantages for the reinsurance option are not listed but can be derived from those shown for the life office.

Advantages

The advantages in setting up and using a wholly owned life office are:

a) Lower premiums, and for some benefits significantly lower premiums, as the life office will require lower margins for expenses and capital than those required by the life insurance industry and also because of the longer term focus of the relationship;

b) Removal of the Mismatch Risk providing improved stability and sustainability of price and product;

c) Enhanced product development capability and innovation;

d) Without having to coordinate with external parties and their priorities, faster delivery of change to products, systems and processes should be possible;

e) Improved the member experience in relation to claims and stability of the product offering because of the consistency of culture, the integration of systems and processes tailored to the fund and its membership and the focus on the member and the longer-term focus of the relationship;

f) An expected return on capital and other investment attributes that are expected to meet the fund investment criteria;

g) No loss in prudent behaviour as the life office is a separate company with its own Board and key staff. In addition, there is rigour imposed through the reinsurance process;

h) Some funds already runs an insurance operation through a long history of self-insurance. While not under the formal structure of a life company it nevertheless means that the fund already has much of the expertise and infrastructure in place that is required for the life office;

i) The life office structure will be simple and its mission very clear and straightforward. This means that the life office should not be as complex as a typical life insurance company; and

j) There is the opportunity to use the life office to provide annuities and other longevity products, particularly with a growing emphasis for accumulation members in Australia on retirement income streams and the lack of any competitive pressure in the life insurance industry in this area.

Disadvantages

The disadvantages are:

a) Set up costs are significant although not large compared with the expense budget of a typical large fund. It is a significant project and will take time and focus of management and the Board and the opportunity costs may therefore be high;

b) The risk of project blowouts in terms of setup costs and opportunity costs;

c) The loss in the immediate term of the commitment of the current insurer to the fund unless it saw some role(s) with the life office e.g. reinsurer, systems provider for systems not currently held by the fund, quality assurance;

d) Ongoing management including attracting and retaining staff;

e) There may be a view that insurance is not a core function of the fund; and

f) There is a risk that the life industry becomes more competitive and efficient making the life office option relatively less beneficial. This is a longer term risk only and would not be expected in the short or medium term.

Joint Venture

Historically, a life office could have been set up as a joint venture between two or more funds, perhaps attractive to smaller funds. However, the increasingly possessive and competitive nature of funds would make this an unlikely option.

General Insurance licence

While only a life office can provide life cover, life or general insurers can provide disability cover. The largest risk area is disability cover and this is where capital is most likely to become scarce.

It may be easier to obtain this licence than a life licence and there are certainly many more general insurers than life insurers in Australia. However, it is difficult to see why APRA would have a different approach.

Having to coordinate with an external life office for death cover would create inefficiencies and reduce the advantages.

While general insurers continue to pay GST there is also a premium disadvantage in this structure.

5. Alternative that introduce structures not currently used

5.1. Use of Derivatives

These arrangements have previously been proposed for life offices for their superannuation fund liabilities (Caputo P, 2015). However, to my knowledge they have not been implemented.

This approach is a way of accessing alternative sources of capital. It ensures the most efficient market based price for the insurance risk.

It could be extended to funds using their own life licence or self-insurance arrangement.

The approach should provide an efficient alternative to reinsurance. Having part of the risk covered by derivatives and an active market established will allow investor interest to build over time.

However their set up is complex and for longer tail claims such as TPD investors may not know their final return (positive or negative) for several years which may make them less attractive for this type of cover. A sunset clause for reporting claims overcomes this issue to some extent, though it is likely the sunset period would be for a fairly long period such as 5 years.

5.2. Self Insurance

Section 1.8 argued that large funds can be viewed as self-insured, or informally self-insured. In these circumstances, trustees should be taking more control of the death and disability benefits they provide to members including in relation to design, pricing, capital and claims management. Rather than being informally self-insured it would be appropriate for them in some circumstances to be formally self-insured.

Under a formal self-insurance arrangement, the services provided by the life office would be brought inhouse by the fund. This type of arrangement is employed by some defined benefit funds for defined benefit members. It has been employed in the past for accumulation members. It is employed by a number of companies in relation to their Workers' Compensation benefits.

The fund would bring the capital element inhouse but may still outsource one or more of the other services provided by a life office. Capital requirements would mirror those required of a life office and would be held in a separate insurance reserve. Most large accumulation funds have already established an insurance reserve for the purpose of the insurance administration fee and the smoothing of the member premium rates.

Although termed self-insurance, this does not mean that 100% of the risk must be carried by the fund. It is most likely that catastrophe cover and/or quota share reinsurance would be part of a self-insurance arrangement.

Self-insurance brings the advantages of the life licence approach with the added advantage of simplicity and significantly lower costs, not only administratively but also in relation to stamp duty which is only payable on the premium of a life company authorised under the Commonwealth Life Insurance Act 1995.

Noting APRA's benchmark of meeting financial promises in all reasonable circumstances (APRA Mission) it is hard to understand why it is so opposed to these types of structures, structures which would have no difficulty meeting this benchmark. The self-insurance structure brings cost and capital efficiencies for members and better end to end servicing.

Unfortunately, under APRA's current rules self-insurance must be translated into a separate life office structure with a separate Board and management and all the additional overheads, processes, systems and costs associated with setting up and maintaining this structure. This adds a significant layer of cost for no practical gain, a cost that must be met by members.

The argument often put forward that this provides a level playing field is a red herring and one that serves to retain the protected status of inefficient structures, rather than address the benefits to the community of change.

Noting that:

- funds that have self-insured have done so prudently and successfully for many years;
- funds are large and are capable of undertaking these activities prudently;
- funds are insourcing many of the functions that were once outsourced most notably investment management as a way of driving more substantive efficiencies for their members; and
- other sectors self-insure most notably Workers' Compensation and private health insurance.

it is time that this option was reconsidered, if not by APRA then perhaps the Productivity Commission or Government looking to bring a better balance to the industry in terms of efficiency and what price the community must pay to retain inefficient structures.

5.3. Pooling

This is one of the most exciting areas where efficiencies can be gained for members.

The idea is not new. Most recently it was suggested in the final report of the FSI (Financial System Enquiry, 2014) in relation to group self annuitisation. It is being progressed through legislation currently being drafted and enacted.

The concept in relation to longevity risk (see Attachment C for more detail) is to create a pool of lives who share the mortality and investment experience. Because there are no guarantees on the income stream (length of time and/or the amount payable) there are no capital requirements, and no requirement for a life office to support the structure. The pool is under actuarial management to enhance the equity of distributions.

This translates quite nicely, in principle, into death and disability benefits. The beauty of the pooling structure is:

a) the simplicity with which the pooling of longevity risk can be replicated into a pooling of mortality and/or morbidity risk;

b) The structure is able to mirror current group insurance structures, processes and benefit designs;

c) It removes a significant layer of expense, capital cost and taxation cost inherent in current structures. This will increase significantly the Benefit Efficiency. Current Benefit Efficiency ratios of 73% would be increased to 90% to 95% and higher, depending on the type of benefits provided by the Pool;

d) It is inherently simpler as it is run solely by the fund without the need for an external party. However, there may be services that the trustee outsources such as underwriting and underwriting tools;

e) If the premium was set on current industry margins, in most years there would be a surplus which could be moved to the Insurance reserve, used to reduce future premiums or used to enhance benefits of the claimants. The approach would be determined by the trustee as it is now and as it is now, generally under actuarial advice;

f) Premiums could alternatively be set on the APRA benchmark basis (APRA Mission) so that under all reasonable circumstances the benefits advised in the form of the sum insured would be met. This wording would similarly be applied in the member communication.

g) higher cover or lower premiums because of the large lift in the Benefit Efficiency. The negligible capital cost or overhead loadings and lower taxation costs would translate into higher benefits and/or lower premiums.

As with group self annuitisation, there would be actuarial management of the Pool.

The benefit is not guaranteed so must be communicated carefully to the member, particularly in relation to the circumstances where the full benefit is not paid and also the principles the trustee will use to determine any enhancement to the benefit if this is proposed to be part of the design.

If the premium is set closer to the expected payments then the design will need to address how any shortfall in assets will be distributed. As the trustee will not be asking for payments to be returned, a staged payment design (not dissimilar to the concepts behind SunSuper's TPD by instalment design) could be implemented including a sunset clause on reporting claims (again as used by Sunsuper). The final payment would be made after the sunset period had expired and the sunset period may differ for death, Terminal Illness, TPD and IP, reflecting the reporting delays of each benefit.

One issue to resolve in the design is that the assets may run out quickly if the experience is poor for example in a pandemic. This would result in much lower than expected benefits. To overcome this, the trustee could purchase pandemic or catastrophe cover. Of course, life policies with their short-term guarantees provide very limited cover in the circumstances of a pandemic and many policies have a pandemic clause as a trigger for rate or policy review.

An Income Protection Pool is attractive as there is a community safety net in the form of the Disability Support Pension should the Pool run out of assets due to high claim rates. This is similar to group self annuitisation with the age pension safety net.

6. Summary and Conclusions

The current structure of the group life industry failed over a number of years to provide trustees with a reasonable market in which to insure their commitments to members. While on the surface, the market has improved, the industry is not fundamentally efficient or competitive and it retains the core structure that magnified the recent instability.

The industry has now lurched into a new crisis, the inappropriate erosion crisis. One solution is to reduce members' benefits which will of course reduce their premium but will perpetuate the current inefficiencies and does not deliver optimum outcomes for members.

The current structure works well for very small funds who cannot afford to cover their very large statistical claim variations. It also works well for those who do not see death and disability benefits as a core offering of the fund and those who want a simple life. There are much better alternatives for all other funds.

Considering the attributes of the various structures discussed in this paper (see Attachment D), it is clear that the trustees of large funds should consider strategically whether or not their current structure is the most efficient, providing the member with the best value for money and the best service.

Some of the alternatives will not suit some funds and some alternatives can be implemented quickly while others require serious business cases and planning and are therefore medium to long term alternatives.

With so much change in the nature of funds and so little change to the insurance proposition it would not be surprising if a number of funds found alternative structures much more appealing for their membership than current structures.

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Attachment A - Services provided to trustees by a life policy

The services provided to trustees by a life policy can be broken down into:

- Capital to cover the risk transfer, so that if the premium is insufficient to cover the claims experience and administrative costs for a contract period, money is available to pay claims;
- Claims Assessment and management;
- Underwriting for cover outside automatic cover levels including underwriting tools;
- Trustee Services such as reporting, assistance with documentation and member communication, advice on experience, advice on design options;
- Member Services such as tools for determining the appropriate amount of cover, the associated premium and for underwriting;
- Technology;
- Brand and image strength; and
- Compliance with the law and regulation.

It is possible to further break these down into people, process, technology, intellectual capital and experience.

Attachment B – Credit Rating of Self Insured Companies

Companies in NSW and Victoria who self-insure have the following Moody's rating:

Moody's Rating	Number of Companies	Credit Risk
Aa2	2	Very low
Aa3	1	Very low
A1	1	Low
A2	1	Low
A3	2	Low
Baa1	4	Moderate
Baa2	5	Moderate
Baa3	2	Moderate
Ba1	1	Substantial
Ba2	1	Substantial
B1	1	High

Attachment C – Group self-annuitisation

The FSI discussed group self-annuitisation and the section is reproduced below.

http://fsi.gov.au/publications/interim-report/08-retirement-income/retirement-income-products/

Group self-annuitisation

In a group self-annuitisation (GSA), participants contribute funds to a pool that is invested in financial assets. Regular payments from the pool are made to surviving members. Pooling mortality risk delivers higher income in retirement than an account-based pension that is drawn down at the minimum rate, while also providing significantly more protection against longevity risk. GSAs allow pool members to share, but not completely eliminate, longevity risk and do not require capital to back guarantees. They can also be offered on a deferred basis like a DLA.

GSA income is not guaranteed like annuity income, but it is expected to be higher due to the absence of capital requirements to back guarantees. The efficiency of the product is 100 per cent (excluding any administrative costs) as the entirety of a pool member's contribution is expected to be paid as income. Income levels may be lower at older ages if, for example, the entire pool lives longer than expected. Members also lose flexible access to capital and are unable to bequeath residual assets.

Singapore's Central Provident Fund Lifelong Income For the Elderly (CPF LIFE) scheme has some characteristics of a GSA. Participation is mandatory for those with retirement account balances above a minimum level. Members choose between two plans: one pays a higher income but leaves less for bequests, the other pays a lower income but leaves more for bequests. Payments are not guaranteed to be constant but are designed to be relatively stable; they are adjusted to reflect actual investment returns and mortality.

Attachment D – Summary comparison and rating of alternative structures

I have rated each structure on a grade of 1 to 3 where 1 is the best structure for the trustee. The rating assumes the structure is in place.

Each alternative assumes the typical current structure applies other than for the features of the alternative structure.

Retaining the existing structure has no transition or implementation costs. Cots of change are not included in the assessments shown by the ratings.

It would be possible and logical to combine some structures e.g. Premium Adjustment and Agreed Margin. I have not rated possible combinations.

Attribute	Typical Current ^	Alternatives that modify current structures						Alternatives that introduce structures not currently used		
		Multiple Reinsurers	Premium Adjustment	Agreed Margin	Stop Loss Insurance	Separate Statutory Fund	Life Licence	Derivatives ^^	Self Insurance	Pooling
Mismatch Risk	**3**	2	3	3	3	2	1	2	1	1
Market Failure *	**3**	2	3	2	3	2	1	2	1	1
Benefit Efficiency	**3**	3	2	2	1	2	2	2	1	1
Risk transfer - Friction of recycled premium	**3**	3	3	3	1	3	2	3	1	1
Simplicity	**1**	2	2	1	2	1	1	3	1	2
Lock In - inability to change	**3**	2	3	3	3	3	1	2	1	1
Cultural Fit with Trustee	**3**	3	3	2	3	2	1	3	1	1
Claims Management Improvements	**3**	3	3	2	3	2	1	3	1	1
Master of own destiny	**3**	2	2	2	3	2	1	2	1	1

* where the market generally fails but the experience of the fund is still reasonable
^ assumed to be a single insurer (with or without a single reinsurer) and no premium adjustment mechanism
^^ assumes a reasonable market of investors can be developed and maintained