INSURANCE COUNCIL OF AUSTRALIA

25 October 2018

The Hon. Kenneth Hayne AC QC
Commissioner
Royal Commission into Misconduct in the Banking,
Superannuation and Financial Services Industry

Submitted through online form

Dear Commissioner

POLICY QUESTIONS ARISING FROM MODULE 6

The Insurance Council of Australia (the Insurance Council) welcomes the opportunity to comment on the policy questions arising from module 6 of the hearings of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (the Royal Commission). As the industry body representing the Australian general insurance industry, the Insurance Council's submission only responds to the questions that are relevant to general insurance.

If you have any questions or comments in relation to this information, please contact Mr John Anning, the Insurance Council's General Manager Policy, Regulation Directorate, on tel: (02) 9253 5121 or email: janning@insurancecouncil.com.au.

Yours sincerely

Robert Whelan
Executive Director & CEO

INSURANCE COUNCIL OF AUSTRALIA

ROYAL COMMISSION INTO MISCONDUCT IN THE BANKING, SUPERANNUATION AND FINANCIAL SERVICES INDUSTRY

Policy Questions Arising from Module 6 – Submission of the Insurance Council of Australia

1. Is the current regulatory regime adequate to minimise consumer detriment? If the current regulatory regime is not adequate to achieve that purpose, what should be changed?

Insurance Council key submission points:

- *While the regulatory regime provides extensive protections for consumers, the emphasis on product disclosure is misplaced, given limited use of mandated disclosures, low financial literacy levels and consumer behavioural bias.*
- *Reforms underway to rebalance the regulatory regime away from product disclosure to heightened product governance will substantially transform and enhance the regime.*
- *The Insurance Council supports a simplification of the regulatory regime through the articulation of core consumer protection principles, accompanied by sector-specific rules and guidance to aid compliance.*

The statutory regulatory regime protecting general insurance consumers is extensive. The key protections are provided through the:

- *Insurance Contracts Act 1984* (Insurance Contracts Act);
- *Corporations Act 2001* (Corporations Act),
- *Australian Securities and Investments Commission Act 2001* (ASIC Act),
- *Insurance Act 1973*; and
- external dispute resolution mechanism provided by the Financial Ombudsman Service (FOS – soon to be the Australian Financial Complaints Authority).

While the law is extensive, the regulatory regime is largely focussed on minimising consumer detriment by requiring the provision of information about products and services. The law mandates the provision of a comprehensive range of information for consumers of general insurance, contained in the Corporations Act and also the Insurance Contracts Act. However, research[1] conducted by the Insurance Council has confirmed that there are limitations to what disclosure can achieve, given:

[1] Insurance Council of Australia (2017), *Consumer Research on General Insurance Product Disclosures*, research findings report.

- only a small number of consumers use the Product Disclosure Statement (PDS) as a pre-purchase information source;
- low observed levels of financial literacy and understanding of basic insurance concepts;
- behavioural bias leading to a consumer focus on price over policy coverage and features.

This shortcoming in the regulatory regime was recognised by the Financial System Inquiry (FSI), which recommended new statutory obligations to require products to be designed and distributed according to an appropriate target market. The *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018* will implement this recommendation and will engender an important shift in the regulatory regime from a focus on product disclosure to a more holistic emphasis on product governance, with enhanced regulatory enforcement powers.

In addition, as noted by the Royal Commission, a number of other regulatory reforms to strengthen consumer protection are currently being considered. The Insurance Council supports sensible reform options to:

- minimise the risk of inappropriate remuneration for product distribution;
- introduce unfair contract terms protections (UCT) for consumers of general insurance; and
- apply general conduct obligations for insurance claims handling;

The Insurance Council's submission addresses these reform options in more detail in our response to questions 7, 29 and 17 respectively.

The Insurance Council submits that additional changes to the regulatory regime, taking account of the above proposed reforms, are not required. In reaching this conclusion, we have considered the ongoing critical role of industry self-regulation in setting standards and norms above the requirements of the law to reflect changes to community expectations over time. Certainly, the latest review of the General Insurance Code of Practice (the GI Code) has focused on incorporating obligations, best practice standards and guidance on topics that have emerged as important issues to the community, such as family violence, mental health and vulnerable consumers.

While we consider that the regulatory regime is adequate, we believe it could be made more effective through simplification. The Insurance Council agrees with the Commission's observation in its Interim Report that the regime for financial services is complex[2]. The objective of financial services reform (FSR) in 2001 was to simplify and streamline the regulation of financial services across different sectors. The broad based application however, has at times made it necessary for the law to be highly prescriptive or require sector-specific exemptions. The need shortly following FSR to tailor the disclosure regime for general insurance products is an example of the difficulty of applying a broad set of rules to widely varying products and services.

[2] Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Interim Report, p.290 (**Interim Report**).

In addition, for insurance where consumer protections are also specifically codified in the Insurance Contracts Act, the interaction between different pieces of legislation developed at separate points in time also creates complexity. For example, there are differences in the type of "consumer" protected in the legislation; for the Corporations Act, the requirements apply to general insurance sold to "retail clients" whereas provisions of the Insurance Contracts Act (such as section 37) has a much broader application.

An unintended consequence is that this complexity often forces attention on technical compliance rather than on the underlying objective to promote good consumer outcomes. In this context, the Insurance Council, in-principle, supports consideration of a simplification of the regime through the articulation of core consumer protection principles. These principles should be accompanied by a clearer mandate for ASIC to interpret how they should apply in a practical way through the making of rules and the provision of guidance that would be tailored to the relevant industry. We believe sector-specific industry codes should continue to play an important role in setting standards which complement the law and ASIC requirements. (These ideas are explored in more detail in the Insurance Council's submission responding to the Interim Report.)

A. PRODUCT DESIGN

2. Are there particular products – like accidental death and accidental injury products – which should not be sold?

Insurance Council key submission point:

- *The regulatory regime should focus on the governance of product design and distribution, not the banning of broad categories of products.*

As a matter of principle, the Insurance Council's view is that insurance products should not be banned from sale unless they are incapable of offering benefits or value to any group of consumers. From a general insurance perspective, the question is how to direct sales to the consumers that could potentially benefit from the relevant product. The Insurance Council is unaware of any general insurance product which does not offer any value to any group of consumers.

The Insurance Council submits that, appropriately designed and distributed, accidental injury general insurance products are suitable for a range of consumer needs. Existing products on the market provide a useful risk management tool for consumers, for example, voluntary workers who are not ordinarily covered by workers compensation arrangements and group policies for sporting clubs where members can access benefits for medical costs.

The impending product design and distribution obligations will require insurers and the distributors of their products to design and sell products appropriate to the needs of consumers in a target market. The obligations will establish a legislative framework to govern conduct around product design and distribution without removing the product issuer's ability to determine whether a product is appropriate.

Given the emerging regulatory emphasis on consumer testing in product development and monitoring of product performance, the industry's ability to anticipate and respond to consumer needs is continually being strengthened.

The product design and distribution obligations will be accompanied by new ASIC powers to intervene in the market to halt the sale of a product or a class of products where it has determined that significant consumer detriment has or is likely to occur. We believe these protections will address the risk of products being inappropriately designed or distributed.

B. DISCLOSURE

4. Is the current disclosure regime for financial products set out in Chapter 7 of the *Corporations Act 2001* (Cth) and Division 4 of Part IV of the *Insurance Contracts Act 1984* (Cth) adequately serving the interests of consumers? If not, why not, and how should it be changed? In answering these questions, address the following matters:

    4.1. the purpose(s) that the product disclosure regime should serve;

    4.2. whether the current regime meets that purpose or those purposes; and

    4.3. how financial services entities could disclose information about financial products in a way that better serves the interests of consumers.

(Despite the reference to the Insurance Contracts Act 1984 (Cth), this question is not limited in scope to contracts of insurance.)

Insurance Council key submission points:

- *The mandated disclosure regime is not currently serving its intended purpose of aiding consumers to make informed choices about their insurance needs.*
- *Providing information at the right time and in a manner that is likely to be comprehended and useful for decision-making is a complex challenge, and the solution is unlikely to be in the form of more mandated disclosure.*
- *The industry is learning from consumer research and testing, and the regulatory regime should foster rather than inhibit innovation.*

The mandated generic disclosure provisions for financial products are contained in Chapter 7 of the Corporations Act. The Product Disclosure Statement (PDS) provisions in Part 7.9 of the Corporations Act are amended by a number of regulations for general insurance products, for example by the addition of Regulations 7.9.15D, 7.9.15E and 7.9.15F. This tailored general insurance disclosure regime requires the PDS to include disclosure required under sections 35 and 37 of the *Insurance Contracts Act 1984*[3]. These additional disclosures relate to any non-standard term that differs from those for prescribed contracts, as well as any unusual term. Division 4 of Part IV of the Insurance Contracts Act also requires a Key Facts Sheet (KFS) to be provided for home and contents insurance, listing prescribed events (such as flood, storm, actions of the sea, etc.) and the policy's coverage in respect of each.

The stated objective of disclosure in the Corporations Act is to provide information that:

> "…a person would reasonably require for the purpose of making a decision, as a retail client, whether to acquire the financial product".

[3] Corporations Regulations 2001 (Reg 7.9.15E).

In its guidance, ASIC broadens this objective by stating that the PDS should help consumers compare and make informed choices about financial products[4]. Hence, mandated disclosure should not only provide product information, but assist consumers in making choices about their insurance purchases. While the Insurance Council agrees that such an objective is appropriate, we note that an additional consideration for insurance is that the PDS also serves as the policy document setting out the contractual terms and conditions of the policy. In this context, the PDS does not only provide information about the product, but embodies the product itself.

While the comprehensive product disclosure regime provides the foundation for transparency, the industry has recognised that complying with the black letter law may not necessarily result in disclosure that is engaging nor effective in aiding decision-making. The law specifies the information that is required to be disclosed, but presenting information at the right time and in way that consumers are likely to comprehend and use to make decisions is a complex challenge. It has been our experience that complying with the law can at times impede effective disclosure.

This is best illustrated by the rules surrounding electronic disclosure. The Insurance Contracts Act is constraining widespread adoption of electronic and innovative forms of disclosure due to the requirement to "give" relevant information and notices, which has resulted in hard copy disclosure remaining the default method of information provision. While the Insurance Council sought legislative reform in 2016[5], no action has been taken as yet by government.

Recognising the need for industry to do more to enhance the effectiveness of disclosure, the Insurance Council Board established an independent Effective Disclosure Taskforce (the Taskforce) in 2015 to recommend initiatives to enhance disclosure. The report[6] handed down by the Taskforce made 16 recommendations, including that the industry should shift from a minimum mandated disclosure approach to best practice transparency to better assist consumers to choose a product that meets their needs. In particular, the Taskforce recommended that insurers should explore more innovative forms of disclosure, including electronic disclosure, that enable information to be delivered in more relevant and personalised ways.

To support innovation in disclosure, the Insurance Council has led industry work since the Taskforce report to better understand how consumer-decision making can best be supported at the point of sale. Research[7] undertaken to date confirms that effectively aiding consumer decision-making is complex. There is no single pathway to purchase and the use of information in decision-making is highly varied. Behavioural bias leads to shortcuts in decision-making, with consumers focusing on simpler considerations such as the price rather

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[4] ASIC (September 2010), *Disclosure: Product Disclosure Statements (and other disclosure obligations)*, Regulatory Guide 168.
[5] Insurance Council of Australia (10 August 2016), *Facilitating electronic disclosure in the insurance sector*, submission to Treasury, http://www.insurancecouncil.com.au/assets/submission/2016/2016_08_10_Mr%20James%20Kelly_Treasury_Submission_Electronic%20Disclosure.pdf
[6] Exhibit 6.404.10, Insurance Council of Australia, Effective Disclosure Taskforce (2015), '*Too Long; Didn't Read. Enhancing General Insurance Disclosure*', report to the Board of the Insurance Council of Australia.
[7] Exhibit 6.404.11, Insurance Council of Australia (2017), '*Consumer research of general insurance disclosures*', research report.

than other important factors such as their individual risk profile and the cover they require. The varied circumstances of consumers, their needs and how they make decisions makes it difficult for a blunt instrument such as the black letter law to be effective. From our perspective, the law should outline the key objectives of disclosure without presenting any barriers to innovation. This would best enable the industry to leverage off the substantial progress currently being made in understanding consumer behaviour and the emerging digital and other solutions being developed.

5. Is the standard cover regime in Division 1 of Part V of the Insurance Contracts Act 1984 (Cth) achieving its purpose? If not, why not, and how should it be changed?

Insurance Council key submission points:

- *It is unlikely the standard cover regime is achieving its purpose of disclosing to consumers non-standard and unusual terms, given the broader limitations of the disclosure regime.*
- *The Insurance Council is supportive of a review of the standard cover provisions.*

Division 1 of Part V of the Insurance Contracts Act, and related regulations, contain the standard cover provisions, which apply to: motor vehicle insurance; home building insurance; home contents insurance; sickness and accident insurance; consumer credit insurance; and travel insurance. The regulations prescribe standard wordings for each of these classes of insurance. The origins of the standard cover provisions was the Australian Law Reform Commission's (ALRC) review into the adequacy of the law of insurance contracts in 1984, which resulted in the codification of insurance law under the Insurance Contracts Act[8].

The ALRC recommended that standard cover be introduced whereby it would be possible for an insurer to derogate from the standard prescribed. Where an insurer offers policies that differ from the standard cover provisions, the Insurance Contracts Act requires the insurer to clearly inform the insured of the non-standard or unusual term. In practice, insurers comply with this obligation by providing a copy of the policy document combined with the PDS which explains the extent of the cover provided. If an insurer fails to make such disclosures, it is obliged to provide standard cover regardless of whether less cover was provided under the actual contract.

It is important to note that the original intent in introducing standard cover was not to standardise policies. The policy objective of standard cover is to bring to the consumer's attention any exclusions and limitations which they might not expect to be in a contract. The provisions were introduced in large part to address information asymmetry between the insurer and consumer prior to the introduction of the financial services disclosure regime in 2001, with the ALRC noting that:

> "The market is at present distorted by the fact that purchaser discrimination is limited to matters like price, little or no account being able to be taken of differences in the nature of the products being sold. Mandatory provision of information relevant to this matter would remove the distortion and facilitate the more effective operation of market forces. While standardisation of contracts might inhibit competition, standard

[8] Australian Law Reform Commission (1982), *Insurance Contracts*, ALRC Report 20.

cover should positively contribute to it by ensuring the provision of information necessary for the making of an informed choice."[9]

The ALRC rejected a scheme of standard contracts in Australia because it considered that standardisation would inhibit product development and competition.

An assessment of whether the standard cover provisions are achieving the intended purpose of effectively disclosing unexpected terms is a complex task. First, whether a term is unexpected is likely to be subjective and dependent on a range of circumstances, including an individual consumer's prior experience and knowledge. In addition, the standard cover wording was developed prior to 1984 based on a review of policies at that time. With the substantial changes to the market since then, the prescribed wording no longer reflects what is offered as 'standard' in today's market. The Insurance Council understands that no insurer actually offers standard cover as prescribed in the legislation, with most of the key differences being additional cover insurers provide in response to the needs of the modern consumer (such as accidental damage for home insurance policies).

The Cameron/Milne review of the Insurance Contracts Act in 2004 considered the effectiveness of the standard cover provisions in detail. In responding to some submissions which suggested that insurers do not disclose non-standard or unusual terms effectively, the review did not consider it appropriate to require separate disclosure outside of the PDS. The review suggested that the provision of more information is unlikely to be effective, and noted that non-standard terms often have to be read in conjunction with the policy and PDS to be fully understood. However, the review did find that the standard cover regulations have not kept pace with market developments, and recommended that they should be reviewed and updated where necessary. The Insurance Council understands that Treasury is currently conducting a review into the standard cover provisions.

As part of the Insurance Council's work on effective disclosure, we are undertaking a second phase of consumer research focused on the way consumers compare policies and expectations around what a "basic" home building and contents policy looks like. The objective of the research is to better understand the criteria for product selection, and how information and product design can help consumers make informed decisions about their insurance needs. We anticipate this consumer research would be insightful and may be a useful resource for Treasury in conducting its review.

6. Is there scope for insurers to make greater use of standardised definitions of key terms in insurance contracts?

Insurance Council key submission points:

- *The Insurance Council is willing to consider the need for more uniform treatment of key policy terms.*
- *Any reform should be evidence-based and informed by comprehensive consumer research and testing.*

[9] Australian Law Reform Commission (1982) *Insurance Contracts*, ALRC 20, p. 45

Currently, the only standardised definition for general insurance contracts is the prescribed definition of "flood" in the Insurance Contracts Act. The definition of flood was standardised following the 2011 Brisbane floods, where variances in the definition were thought to have caused substantial confusion amongst insureds as to whether they were covered for flood.

As part of its work on effective disclosure, the Insurance Council has been exploring the need for other key definitions in home insurance policies to be standardised across the industry. This work has initially focused on key exclusions and variations in definitions, with the Insurance Council reviewing existing policies across the industry as well as having discussions with consumer advocates and the Financial Ombudsman Service (FOS).

The Insurance Council's preliminary analysis has confirmed that the most significant variation in definitions relates to "actions of the sea" exclusions in home insurance policies. Definitions varied in whether exclusions capture damage caused by storm surge, with some policies providing cover but others not.

The analysis also found more minor variations in definitions in relation to other exclusions, such as wear and tear, where definitional differences relate largely to the level of detail used to describe these exclusions. There is currently no data to provide insights as to the impact of these definitional differences on actual consumer outcomes.

In addition, it has been suggested by some stakeholders that factors other than definitional differences, such as financial literacy, are likely to have a greater impact in hindering consumer comprehension and decision-making. It has been suggested that broad exclusions such as wear and tear are commonly not well understood, and can be difficult to apply consistently. Certainly, consumer research conducted by the Insurance Council would suggest that when purchasing insurance, many consumers do not consider policy exclusions and limits to a great extent.

The Insurance Council's second phase of research into effective disclosure will explore in greater depth the way consumers compare policies, and whether policy differences (including definitional differences) create a barrier to effective decision-making. While the Insurance Council is willing to consider the need for more uniform treatment of key policy terms, this work should be evidence-based and informed by comprehensive consumer research and testing.

C. SALES

7. Should monetary and non-monetary benefits given in relation to general insurance products remain exempt from the ban on conflicted remuneration in Division 4 of Part 7.7A of the *Corporations Act 2001* (Cth)? If so, why?

Insurance Council key submission points:

- *The Insurance Council considers that a ban on commission-based remuneration for the sale of retail general insurance is not warranted.*
- *The Insurance Council is supportive of exploring reform options to ensure commissions do not exceed acceptable levels.*

Division 4 of Part 7.7A of the Corporations Act prohibits an Australian Financial Services (AFS) licensee from accepting conflicted remuneration, and product issuers from giving conflicted remuneration to a licensee. Conflicted remuneration is defined as any monetary or non-monetary benefit connected with the provision of personal or general advice that could influence the choice of financial product recommended, or the advice given, to retail clients. Regulation 7.7A.12G exempts benefits in relation to general insurance products from the conflicted remuneration provisions. This exemption was put in place when the Future of Financial Advice (FOFA) reforms were developed in recognition of the differences between advice provided in the context of general insurance and other financial products.

Retail general insurance is sold either directly to the consumer by the insurer or through an intermediary. Intermediated sales include distribution through an agent or authorised representative of the insurer, or through an agent of the consumer (such as an insurance broker). The availability of both direct and intermediated channels provides consumers with options in selecting a policy that meets their needs. While many consumers may prefer to purchase insurance directly from the insurer, the intermediated channel provides another option for consumers to purchase insurance at the time that they need it. For example, for home insurance, many consumers value the convenience of purchasing insurance through the same financial institution that is processing their loan.

For intermediated sales, commissions are a common method of remunerating product distributors for the service provided. There are costs for all forms of distribution. For intermediated sales these costs are embodied in the commissions paid, whereas for direct sales these costs are internal to the insurer. Distribution costs include the cost of training staff and the cost of building IT systems to enable underwriting to occur at the point of sale.

The Insurance Council submits that commission-based remuneration continues to play a legitimate role in supporting the accessibility of general insurance products. Other policy settings within the Corporations Act recognises the importance of not unduly constraining the distribution of general insurance products to support wide community access to appropriate risk cover[10]. Banning commissions for the sale of general insurance will have a substantial impact on the intermediated sales channel. We anticipate that a move towards a fee-for-service model will significantly affect the viability of intermediated sales and will have significant implications for the competitive landscape of the industry. This will also reduce access to insurance for some consumers and diminish choice in the way consumers purchase insurance

In particular, banning commissions will be detrimental to brokered sales. While sales of retail insurance intermediated by an insurance broker are small in comparison to direct and other intermediated channels, insurance brokers are responsible for the large majority of insurance sales to commercial entities. If commission sales for retail insurance were to be banned, given that the majority of their business would continue to be remunerated through commission, it is likely that brokers would cease providing advice on retail insurance products. The cost of instituting new and separate remuneration arrangements for such a limited amount of business would be prohibitive. This would be detrimental to consumers

[10] See for example *ASIC Corporations (Basic Deposit and General Insurance Products Distribution) Instrument 2015/682* which allows the distribution of general insurance products by distributors who are not authorized representatives to facilitate wider access to general insurance products.

who require the services of a broker in selecting a policy, for example, because they require cover for unique risks.

While we acknowledge that inappropriate commission levels were identified in relation to benefits provided to motor dealer intermediaries distributing add-on insurance products, the add-on market is unique in that all sales are intermediated. For other general insurance products such as home and motor, the existence of a large direct market has acted as a disciplinary force in placing downward pressure on commission levels.

Account also needs to be taken of the fact that the problems associated with commissions identified in the motor dealer intermediated add-on insurance market are different to the issues being addressed by the conflicted remuneration provisions in the Corporations Act. The conflicted remuneration provisions address inappropriate advice provided to consumers as a result of the benefits received by the adviser. This differs from the issues identified by ASIC whereby the significant bargaining power of motor vehicle dealers in negotiating higher commission payments drove "reverse competition" in the market[11]. In this context, the remuneration arrangements were inappropriate as costs passed onto consumers significantly reduced the value of products and also incentivised poor sales conduct.

The add-on insurance example demonstrates the difficulty of voluntary industry action to address issues related to remuneration. The Insurance Council, as noted in the case study explored by the Commission, attempted to seek approval from the Australian Consumer and Competition Commission (ACCC) to implement a voluntary uniform commission cap which was not authorised. While insurers have since individually taken action to reduce the level of commissions paid, a uniform voluntary or legislated cap would provide a more certain solution to ensure commissions remain at an acceptable level.

Simply removing the exemption for general insurance in Division 4 of Part 7.7A of the Corporations Act will not address the issues experienced in the motor dealer intermediated add-on insurance market, and will capture legitimate benefits provided elsewhere in the industry. We note that the removal of the exemption for benefits in relation to life insurance products in 2017[12] required adjustments to the conflicted remuneration provisions so that they applied sensibly to these products. While the definition of conflicted remuneration for life insurance was extended to the provision of information and dealing, rather than just in connection with the provision of advice, the ban does not apply where commissions are capped as prescribed.

The Insurance Council considers that a commission ban for the sale of general insurance is not warranted. However, we see merit in the Government exploring with industry options for regulatory action, such as the imposition of caps, to ensure commissions are not so significant that they distort consumer outcomes. This could be accompanied by greater transparency about commission payments, such as clearly disclosing the portion of the premium attributable to commissions and other intermediary fees. Any such reform should be confined to retail general insurance policies, and should be mindful of differences across

[11] ASIC (September 2016), *A market that is failing consumers: The sale of add-on insurance through car dealers*, Report 492.

[12] *Corporations Amendment (Life Insurance Remuneration Arrangements) Act 2017 (Life Insurance Remuneration Act).*

the suite of general insurance products and the associated variation in the level of commissions in the market.

9. Is banning conflicted remuneration sufficient to ensure that sales representatives do not use inappropriate sales tactics when selling financial products? Are other changes, such as further restrictions on remuneration or incentive structures, necessary?

Insurance Council key submission points:

- *No further restrictions on remuneration are required.*
- *Inappropriate sales conduct will be directly addressed through the new product design and distribution obligations and new standards under the GI Code.*

The Insurance Council is not supportive of a blanket ban on commission payments for the sale of general insurance products, as noted in our response to Question 7.

Apart from exploring options to cap commissions, in terms of minimising the recurrence of poor consumer outcomes examined by the Royal Commission, we do not see the need for any further restrictions on remuneration or incentive structures. We note that the impending product design and distribution obligations will directly address the risk of consumers purchasing products that are unsuitable for their needs. ASIC will have the power to intervene in the market where inappropriate conduct occurs, and we understand ASIC intends to use these powers to address inappropriate remuneration arrangements.

We note that the next iteration of the GI Code will incorporate the following changes to bolster standards in relation to sales conduct:

- insurers will be required to have policies and procedures for employees and distributors to conduct sales appropriately and prevent unacceptable sales practices;
- insurers will be required to make it clear to employees and distributors selling their products that pressure selling is not permitted;
- distributors will be required to notify insurers of any complaints made within two business days; and
- insurers will be required to monitor the sale practices of employees and distributors.

10. Should the direct sale of insurance via outbound telephone calls be banned? If not, is the current regulatory regime governing the direct sale of insurance via outbound telephone calls adequate to avoid consumer detriment? If the current regulatory regime is inadequate, what should be changed?

Insurance Council key submission points:

- *Members are considering the findings of ASIC's review into life insurance and its recommendation that outbound calls for life and funeral insurance be limited.*

Under the Corporations Act, product issuers and sellers must not offer financial products in the course of, or because of, an unsolicited meeting or telephone call. This prohibition is set out in the "anti-hawking" provisions under section 992A and is intended to prevent pressure selling of financial products to retail clients.

In its recent review of the sale of direct life insurance[13], ASIC observed instances of inappropriate conduct and consumer outcomes in relation to outbound calls and indicated its intention to restrict outbound sales calls for life and funeral insurance. ASIC's review was informed by metrics indicating poor product performance and a review of sales calls.

While ASIC's review focused on life insurance products, the Insurance Council and its members are considering the findings in detail. We note that there are significant differences between life and general insurance products; in particular, ASIC's observation that the complexity of life insurance makes outbound sales calls inappropriate is not as relevant for general insurance products. Care needs to be taken to avoid any unintended consequences of restricting outbound calls, such as where the consumer has genuinely provided consent to participate in a call.

11. Is Recommendation 10.2 from the Productivity Commission's report on "Competition in the Australian Financial System", published in June 2018, sufficient to address the problems that can arise where financial products are sold under a general advice model (for example, the sale of financial products to consumers for whom those products are not appropriate)? If not, what additional changes are required? Are there some financial products that should only be sold with personal advice?

Insurance Council key submission point:

- *The Insurance Council is supportive of changes to the regime to enable insurers to provide more tailored product information to consumers without triggering the personal advice rules.*

The Productivity Commission's report recommended that general advice should be renamed so that the term "advice" can only be used in connection with personal advice where the advice has taken into account the individual consumer's circumstances.

While the Insurance Council shares the concerns of the Productivity Commission that the term general advice may mislead consumers into thinking that they are receiving personal advice, our view is that a much more comprehensive review is required of how some general advice activities are regulated. Our experience is that the current regulatory regime unnecessarily constrains the ability of licensees to provide simple product information. Renaming general advice will not of itself address the issues faced by general insurers around the advice definitions of the Corporations Act.

The difference between information that is personal advice, general advice and factual information can be minor. Compliance with the financial advice regime therefore inevitably focuses training for employees and agents on phrasing information so as to allow them to remain within the definition of the advice model they are operating under, rather than on delivering information that is of the most assistance to the consumer's inquiry.

To comply with the personal advice regulatory regime is expensive and unnecessarily cumbersome for general insurance products. Consequently, the majority of general insurance is sold on a no-advice business model, or where advice is provided, care is taken

[13] ASIC (August 2018), *The sale of direct life insurance*, Report 587.

that it falls within the less onerous definition of general advice. The industry is not commonly called upon to provide complex advice. However, the fear of triggering the legal definition of personal advice hinders insurers from being more forthcoming in the guidance they provide. This results in a detrimental outcome for both industry and consumers.

Where, prior to the introduction of the FSR regime, simple insurance products could be offered with some basic advice around product information and needs, the legal requirements now attached to the provision of advice, personal or general, have resulted in the consumer being provided with limited or no advice at all. The Insurance Council considers that this constraint has hindered insurers' engagement with consumers in choosing policies best suited to their needs.

The Insurance Council is supportive of more comprehensive changes to the regime to enable insurers to provide more tailored product information to consumers without triggering the personal advice rules.

D. ADD-ON INSURANCE

13. Should the sale of add-on insurance by motor dealers be prohibited?

Insurance Council key submission point:

- *Add-on insurance distributed through motor dealers should not be prohibited.*

As noted in our response to Question 2, the Insurance Council's view is that policy-makers should not constrain consumer choice by prohibiting the sale of certain products. Rather, the focus should be on ensuring that they are sold in ways appropriate to the particular sales channels. Distribution through dealerships allow consumers to consider and purchase these products at the same time as they purchase or finance their vehicles; it allows these products to be offered and conveniently available when consumers need them.

With the impending product design and distribution obligations, product issuers will be required to design products according to the needs of a target market and ensure that appropriate distribution conditions are set. ASIC will also be able to intervene in the market should it identify distribution conduct that is causing or likely to cause consumer detriment.

We note that the issues identified by ASIC in relation to the sale of add-on insurance through the motor dealer channel have already, or are being, addressed. In addition to ASIC's proposal to implement a deferred sales model (DSM), members have worked with ASIC to make the following improvements or commitments:

- strengthening of sales systems to identify and prevent sales to consumers who would receive little or no benefit from the products;
- refunds for future customers who buy policies they were unable to substantially benefit from at the time of purchase;
- strengthening of dealership training on compliance and systems to ensure that appropriate conduct is clearly defined;
- regular review of policy inclusions and exclusions to maximise product coverage for the benefit of consumers;

- more effective point of sale disclosure designed with insights from behavioural economics research and strengthened post sale communication practices; and
- offering consumers financed and non-financed premium payment options.

The GI Code is also being amended[14] to incorporate these strengthened sales standards, including best practice principles on product design and distribution specifically targeted at the sale of add-on insurance through the motor dealer channel. These principles were developed with ASIC and consumer stakeholders.

While the industry's attempt to implement a voluntary uniform cap on commissions was unsuccessful, individual insurers have taken action to reduce commission levels. ASIC is collecting data from the industry to enable it to monitor the level of commissions, and we understand commission levels are currently comparable to the legislative cap prescribed for the sale of consumer credit insurance (CCI) at 20 percent.

14. Alternatively, should add-on insurance only be sold via a deferred sales model? If so, what should be the features of that model?

Insurance Council key submission points:

- *The Insurance Council supports a deferred sales model being introduced for add-on insurance sold through motor dealer intermediaries and CCI sold through financial institutions.*
- *There needs to be more rigour in defining the features of "add-on" insurance where regulatory intervention is required.*

The Insurance Council supports the introduction of a DSM for add-on insurance[15] sold through the motor dealer channel. ASIC found that specific features of the motor dealer sales environment can impede effective consumer decision-making; specifically, the insurance is not the primary purchase and consumers may not have intended to purchase insurance at the dealership. A DSM would address this by lengthening the time period between product introduction and purchase decision so that consumers would be better enabled to consider their needs during the deferral period. By deferring the consumer's decision-making, information overload and decision fatigue at the point of sale is ameliorated.

The industry has developed and submitted a preferred model to ASIC[16], which is graphically presented at **Attachment 1** to this submission. This model defers the sale of insurance by four days, and in order for it to assist informed decision-making, the Insurance Council has also suggested that the mandated deferral should be accompanied by:

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[14] Insurance Council of Australia (June 2018), *Review of the General Insurance Code of Practice*, final report, http://codeofpracticereview.com.au/assets/Final%20Report/250618_ICA%20Code%20Review_Final%20Report.pdf

[15] Specifically, CCI, GAP insurance, loan termination insurance, tyre and rim insurance, mechanical breakdown insurance, fleet leasing products and warranties.

[16] Insurance Council of Australia (October 2017), *Consultation paper 294 – The sale of add-on insurance and warranties through caryard intermediaries*, submission to ASIC, http://www.insurancecouncil.com.au/assets/submission/2017/October%202017/2017_10_23_ICA_submission_DSM.pdf

- insurer systems and processes requiring confirmation of customer eligibility to claim prior to product introduction;
- the provision of key but concise information at product introduction, including product exclusions and limits; and
- a prohibition for the sales representative to initiate contact with the consumer about the insurance until the conclusion of the deferral period, unless the consumer has initiated contact and there is a record of this contact.

We are aware that members are discussing with ASIC the potential for innovative forms of disclosure to be provided at product introduction and also during the deferral period to maximise its impact on consumer decision-making.

In addition to add-on insurance sold through motor dealer intermediaries, the Insurance Council is also developing a new GI Code obligation that will similarly defer the sale of CCI distributed through financial institutions. The sales environment for CCI sold alongside credit cards and personal loans in person (for example, a bank branch) or over the phone may have similar characteristics to the motor dealer channel. The Insurance Council is consulting with ASIC on the implementation of this GI Code obligation.

"Add-on" insurance has recently been used to describe a broad range of products that have not been the subject of ASIC's review. Suggestions that the reforms being considered for the products distributed through motor dealer intermediaries should also apply to other "add-on" products have lacked a rigorous approach in defining the features of the motor dealer channel that have made regulatory intervention necessary. The Insurance Council considers that features of add-on insurance sold through motor dealer intermediaries which create concern are:

- **Lack of a direct market** – motor add-on products are exclusively distributed through motor dealers, given the convenience to consumers of being able to purchase insurance while also purchasing the motor vehicle. The lack of a direct market contributed to "reverse competition" whereby motor dealer intermediaries were able to exert market pressure to push up commission payments.
- **Need for cover is not immediate** – cover provided by motor add-on products do not generally commence until delivery of the vehicle, given the need for cover does not arise until this point. As such, a DSM can be an effective solution to provide consumers with more time to consider their needs without necessarily creating a gap in insurance cover. This differs for other products such as travel insurance where the cover commences immediately, for example, insureds can make a claim for cancelled travel once the policy is purchased. Applying a DSM to travel insurance would create an insurance gap where the consumer is not covered until after the deferral period.

The Productivity Commission[17] has recommended that the appropriateness of a DSM should be considered for other products such as travel insurance sold through travel agents and airlines. Whether a DSM is appropriate for these types of sales needs to be carefully considered and balanced with the risk of non-insurance. The industry has contributed to an extensive Government campaign to better educate the public about the detrimental impacts

[17] Productivity Commission (August 2018), *Competition in the financial system*, Inquiry final report, https://www.pc.gov.au/inquiries/completed/financial-system#report.

of under and non-insurance when travelling overseas, and this important work should not be undermined.

15. Would a deferred sales model also be appropriate for any other forms of insurance? If so, which forms?

Insurance Council key submission point:

- *The Insurance Council has not identified any other forms of insurance where a deferred sales model is necessary.*

The Insurance Council considers that a DSM is appropriate for the sale of add-on insurance through motor dealer intermediaries and CCI through financial institutions. The rationale for introducing a DSM in these situations is informed by research and reviews commissioned by ASIC into the interaction between those products and the specific features of those sales channels. The Insurance Council is not aware of similar issues experienced for other insurance products that would warrant the implementation of a DSM.

We note that the DSM currently being developed by ASIC is responding to very specific issues associated with particular products sold through the motor dealer channel. Even within this channel, a DSM will not be appropriate for insurance products such as comprehensive motor and compulsory third party insurance given: these are commonly purchased consumer products; non-insurance may have significant consequences; they almost universally provide value to consumers; and they are generally well understood. Similarly, the DSM being developed by ASIC is unlikely to apply to the same products sold online given consumer decision-making will be influenced by a completely different set of factors.

Any decision to extend the DSM to other products should be based on clear evidence that it would improve consumer outcomes, and should be designed to apply appropriately with the specific characteristics of those markets in mind.

16. If the ban on conflicted remuneration is not extended to apply to general insurance products, should the payment of commissions for the sale of add-on insurance by motor dealers be limited or prohibited?

Insurance Council key submission point:

- *The Insurance Council supports a regulated cap on commissions for retail add-on insurance sold through motor dealer intermediaries.*

The Insurance Council supports a cap on commissions for add-on insurance sold through the motor dealer channel to retail consumers. The industry's application[18] to the ACCC sought authorisation to effectively extend the legislative 20 per cent cap on CCI products under the National Credit Code to all add-on insurance products distributed through the motor dealer channel.

[18] Aioi Nissay Dowa Insurance Company Australia Pty Ltd & Ors (September 2016), A91556 & A91557, https://www.accc.gov.au/public-registers/authorisations-and-notifications-registers/authorisations-register/aioi-nissay-dowa-insurance-company-australia-pty-ltd-ors-authorisation-a91556-a91557.

While the industry's attempt to implement a voluntary uniform cap on commissions was unsuccessful, individual insurers have taken action to reduce commission levels. ASIC is collecting data from the industry to enable it to monitor the level of commissions, and we understand that average levels are likely to be comparable to the legislative cap prescribed for the sale of consumer credit insurance (CCI) at 20 percent. In order to achieve a lasting and comprehensive resolution of this issue, the Insurance Council sees merit in pursuing through regulation a uniform mandated cap. This would provide a more certain solution and ensure a continued level playing field for industry participants.

E. CLAIMS HANDLING

17. Should the obligations in section 912A of the *Corporations Act 2001*(Cth) apply to all aspects of the provision of insurance, including the handling and settlement of insurance claims?

Insurance Council key submission points:

- *The Insurance Council is not opposed to extending the section 912A obligations to claims handling.*
- *However, applying these obligations should not inadvertently extend the licensing and financial advice rules to claims handling.*

Section 766A(2)(b) of the Corporations Act and regulation 7.1.33(1) – (2) of the Corporations Regulations excludes 'handling insurance claims' from the definition of financial service. This means that the general obligations under section 912A do not apply to claims handling, including to:

- do all things necessary to ensure that the financial services covered by the licence are provided efficiently, honestly and fairly;
- have in place adequate arrangements for the management of conflicts of interest;
- comply with conditions of the licence;
- comply with, and take reasonable steps to ensure representatives comply with, financial services laws;
- have available adequate resources to provide the financial services covered by the licence and to carry out supervisory arrangements;
- maintain the competence to provide the financial services; and
- ensure that representatives are adequately trained and are competent to provide the financial services.

The Insurance Council understands that the exception was originally put in place to allow insurers to have discussions with insureds during claim time without triggering the financial advice rules. For example, the personal advice rules may be triggered by discussions between claims management staff and the insured around the quantum of a claim. Applying the financial advice regime to claims handling would make existing processes more costly, without any anticipated benefits for consumers. Another reason for the exception was recognition of the impractical nature of capturing within the financial services regulatory net

the range of parties which play a role in the claims management chain, for example, smash repairers. All of these reasons for the exception are still valid.

Notwithstanding the exception under the Corporations Act, ASIC has powers to regulate conduct in relation to claims handling. Reforms to the Insurance Contracts Act in 2013 explicitly made clear that the duty of utmost good faith is available in respect to claims handling or settlement of a potential claim. Under the Insurance Contracts Act, ASIC is able to:

- take licensing action for a breach of the duty of utmost good faith in relation to claims handling;
- take representative action on behalf of third-party beneficiaries (as well as policyholders); and
- intervene in any proceedings under the Insurance Contracts Act.

It should be noted that, under the Treasury Laws Amendment (ASIC Enforcement) Bill 2018 currently before Parliament, civil penalties will be able to be applied for breaches of utmost good faith.

Further, while claims handling is expressly excluded from the definition of 'financial service' under the Corporations Act, it is ASIC's view[19] that claims handling falls within the definition of 'financial service' under paragraph 12BAB(1)(g) of the ASIC Act, which states:

> "(1) For the purposes of this Division, subject to paragraph (2)(b), a person provides a financial service if they:
>
> (g) provide a service that is otherwise supplied in relation to a financial product"

The impact of capturing claims handling under the ASIC Act is that conduct involving insurance claims handling can be caught by the consumer provisions under Division 2 of Part 2 of the ASIC Act, including section 12DA which prohibits misleading or deceptive conduct in relation to financial services.

Under the GI Code, insurers are already obliged to meet a number of claims handling service standards, including a general obligation to conduct claims handling in an honest, fair, transparent and timely manner. There are also standards applying to service suppliers, including suppliers utilised for claims handling such as investigators, loss assessors and claims management service providers. Under the next iteration of the GI Code, there will also be comprehensive mandatory standards on claims investigations.

ASIC's recommendation that the claims handling exception in the Corporations Act is removed arose from its review into life insurance claims handling[20]. In Report 498, ASIC suggested that the exclusion restricts its ability to take action for conduct such as:

- incentives for claims handling staff and management, including whether they are in conflict with the insurer's obligation to assess each claim on its merit;

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[19] ASIC (August 2011), *Review of general insurance claims handling and internal dispute resolution procedures*, Report 245.
[20] ASIC (October 2016), *Life insurance claims: An industry review*, Report 498.

- surveillance practices by investigators, particularly for mental health claims; and
- unnecessary or extensive delays in handling claims.

While we consider that there is already sufficient oversight of claims handling practices, we are not in-principle opposed to extending the general obligations under section 912A to claims handling. However, care should be taken not to inadvertently extend the licensing and financial advice rules to claims handling.

This would have a substantial impact by requiring the range of providers involved in the claims management chain (including loss adjusters, loss assessors, investigators and builders) to be licensed (as a provider of financial services) and the information provided through the course of a claim will need to comply with the financial advice rules.

A possible option is for regulation 7.1.33(1) to be retained (the advice limb of the exception), but for regulation 7.1.33(2) to be removed (the dealing limb of the exception). It would need to be clear that this would not require third parties engaged by insurers to handle claims to obtain an AFS Licence. If the exception is removed (or partially), there would also need to be clearly defined roles for ASIC, APRA and the CGC in order to avoid duplication, including pathways to escalate disputes in relation to individual claims.

18. Should ASIC have jurisdiction in respect of the handling and settlement of insurance claims?

As noted in our response to question 17, we consider that ASIC already has jurisdiction in respect of the handling and settlement of insurance claims.

Life insurance

21. Should life insurers be prevented from engaging in surveillance of an insured who has a diagnosed mental health condition or who is making a claim based on a mental health condition? If not, are the regulatory requirements sufficient to ensure that surveillance is only used appropriately and in circumstances where the surveillance will not cause harm to the insured? If the current regulatory requirements are not sufficient, what should be changed?

Insurance Council key submission point:

- *The Insurance Council does not support a ban for surveillance activity to be conducted where an insured has a mental health condition.*
- *The new GI Code will incorporate mandatory standards to require insurers to minimise the impact of surveillance on consumers experiencing vulnerability.*

While this question is posed for life insurance, it is also relevant to some general insurance products where cover is provided in respect of mental health (for example, travel insurance). While surveillance is used for only a very small number of claims in general insurance, appropriately and sensitively conducted, it is an essential mechanism for insurers to manage the risk of fraud.

We note that the next iteration of the GI Code will include mandatory standards on the use of investigators, which require insurers to take additional steps to minimise the impact of

surveillance on consumers experiencing vulnerability, including consumers with a mental health condition.

General insurance

22. Should the General Insurance Code of Practice be amended to provide that, when making a decision to cash settle a claim, insurers must:

    22.1. act fairly; and

    22.2. ensure that the policyholder is indemnified against the loss insured (as, for example, by being able to complete all necessary repairs)?

Insurance Council key submission point:

- *The existing claims handling obligations under the GI Code are sufficient.*

Under the GI Code, signatories are already required to conduct claims handling in an honest, fair, transparent and timely manner[21]. We consider that this broad obligation sets an appropriate standard to ensure that claims outcomes are appropriate, including for claims that may be wholly or partially cash settled.

Regardless of the obligations under the GI Code, we acknowledge that issues can arise from time to time given the complexity of some claims. Several of these complexities were explored through the Commission's case studies. While we understand the rationale for proposing a GI Code obligation that would require an insurer to ensure that the insured is able to complete all necessary repairs for the amount of the cash settlement, we are concerned about the consequential exposure for insurers.

It is reasonable to expect that an insurance policy defines the quantum of loss that a consumer and insurer could expect the policy to cover. All policies include limits and conditions to enable the risk to be priced and reflected in a premium that consumers are willing to pay. An obligation requiring insurers to cover all necessary repairs diminishes an insurer's ability to set risk limiting conditions, such as sums insured limits and exclusions for damage where the insured had contributed to the loss and may impact on the appetite to provide cover.

The Insurance Council considers that the obligations under the GI Code, the Insurance Contracts Act and ASIC Act provide robust oversight of claims handling conduct. Where issues do arise, we consider that there are sufficient avenues for consumers to seek redress, including through external dispute resolution.

G. SCOPE OF THE INSURANCE CONTRACTS ACT 1984 (CTH)

29. Is there any reason why unfair contract terms protections should not be applied to insurance contracts in the manner proposed in "Extending Unfair Contract Terms Protections to Insurance Contracts", published by the Australian Government in June 2018?

[21] Exhibit 6.404.21, General Insurance Code of Practice, section 7.2.

Insurance Council key submission points:

- *The Insurance Council supports the application of UCT protections to insurance contracts so that consumers can challenge insurance contracts for unfairness while the commercial basis on which the contracts are underwritten is protected.*
- *The key elements of the model proposed for insurance in the Treasury Proposals Paper would operate more severely and create far more uncertainty than application of the general UCT regime.*

As explained in the Insurance Council submission of 24 August 2018 responding to a Treasury Proposals Paper (provided to the Royal Commission under NP 1325 of 27 August 2018), the Insurance Council supports the application of UCT protections to insurance contracts[22]. However, the Insurance Council and its members are seriously concerned that the key elements of the model proposed for insurance in the Proposals Paper would operate more severely, and create far more uncertainty, than the general UCT regime does for other sectors of the economy[23].

The Productivity Commission's recommendation in 2008 was that the national generic consumer law should address unfair terms in standard form contracts in order to prevent a significant imbalance in the parties' rights and obligations arising under the contract.[24] The same goal should guide the current consultation on how to implement the Government's decision to apply UCT protections to insurance contracts. It should not seek to review the merits of the commercial bargain underlying the policy by applying a narrow interpretation of the exemption for terms which define the main subject matter or taking a restrictive view on the legitimate interests of the insurer.

Below are the Insurance Council's key concerns regarding the proposed regime set out in Treasury's discussion paper. These are explained more fully in the Insurance Council's submission of 24 August 2018.

Main Subject Matter

Under the proposal advocated in the Proposals Paper, the 'main subject matter of the contract' would be defined narrowly as terms that describe what is being insured.[25] Under this approach, the terms of an insurance contract setting out the risks covered would be reviewable, with the insurer required to justify why they are necessary to protect their legitimate interests. This goes to the commercial bargain at the heart of the contract and is more onerous than what is applied to other sectors.

The approach taken in the Proposals Paper to the main subject matter reflects the references to the subject matter of an insurance contract in the Insurance Contracts Act[26]. Such a narrow interpretation of main subject matter is not taken for any other financial

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[22] Exhibit 6.406.
[23] In the ASIC Act and the equivalent provisions in the Australian Consumer Law.
[24] Productivity Commission, Report into Australia's Consumer Policy Framework, Recommendation 7.1, volume 1, page 69.
[25] Treasury Proposals Paper "Extending Unfair Contract Terms Protections to Insurance Contracts" June 2018 (at 34)
[26] See Insurance Contracts Act sections 16,17,18,42,44,49,50,54,58,60,65 and 75.)

service or sector of the economy. Consequently, its impact would make far more of an insurance contract reviewable for unfairness than under the general regime.

The impact of the uncertainty created by the proposed model on insurers will be significant. If insurers cannot rely on the terms forming the basis of their contracts, they will need to reprice the risks being underwritten and there will be significant implications for their reinsurance arrangements and the regulatory capital they need to hold. In turn, this will affect the scope of policy coverage and lead to higher premiums for consumers.

The Australian Consumer Law Review's Final Report proposed that applying UCT protections to insurance contracts would be consistent with the regulatory treatment in the UK and New Zealand. Legal advice received by the Insurance Council confirms that in the UK, application of the UCT provisions needs to take account of the European Council Directive (93/13/EEC) on the treatment of unfair terms in consumer contracts. This includes the following exemption for insurance contracts:

> *"…the terms which clearly define or circumscribe the insured risk and the insurer's liability shall not be subject to such assessment since these restrictions are taken into account in calculating the premium paid by the consumer;"*

The Insurance Council submits that adoption of the European approach to the main subject matter of the contract would allow insureds to challenge terms which unfairly prevent them from receiving the protection which they thought they had purchased, while giving insurers certainty that the commercial basis of the insurance contract would not be undermined. As highlighted in the proposals paper[27], the European Commission's 2017 evaluation of its consumer directives concluded that the protections remain fit for purpose.

Meaning of Unfair

Treasury proposes that, when determining whether a term is unfair, a term will be reasonably necessary to protect the legitimate interests of an insurer if it reasonably reflects the underwriting risk accepted by the insurer in relation to the contract and it does not disproportionately or unreasonably disadvantage the insured.[28]

While the need to manage underwriting risk is central to many terms of an insurance contract, it is not the only factor taken into account. For example, terms requiring the disclosure of relevant information would go to overall risk appetite. Furthermore, making the test for protection of legitimate commercial interests dependent on the impact on the particular insured, and not the whole class of insureds, would undermine the nature of insurance and create significant contractual uncertainty. It would often be the case that the theoretical cost to the insurer of providing cover to a particular consumer (say for example for termite damage) would be relatively modest but the impact to that consumer of rectifying the damage could be significant.

Consequently, the Insurance Council submits that it is unnecessary to tailor the definition of unfairness in relation to insurance contracts and the generic approach taken in the ASIC Act and Australian Consumer Law should apply.

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[27] *Id*. at 28.
[28] *Id*. at 38.

Introduce the existing UCT laws into the Insurance Contracts (IC) Act

The Insurance Council's preferred option for extending UCT protections to insurance contracts is to introduce a stand-alone set of UCT protections in the IC Act which largely mirror those in the ASIC Act. If a Court is to have the ability to choose the most appropriate remedy for a term found to be unfair, it makes sense for the remedies to be found together in the Insurance Contracts Act. However, careful consideration would need to be given to how a UCT regime for insurance contracts would interact with the established UGF regime, particularly as a UCT regime for insurance contracts would introduce another, different concept of fairness into the Insurance Contracts Act. It would be helpful if the legislation clarified that not all terms found to be unfair would necessarily be breaches of the duty of UGF.

Need for the legislation to reflect how it is intended to be used

One argument put forward in stakeholder consultations is that there should be no concern if the wording of any amendment applying UCT protections exposes key parts of an insurance contract to review. The rationale being that legal action would be expensive for both consumers and their advocates and ASIC, leaving enforcement to be implemented by ASIC through consultation with relevant insurers on the need to amend a term thought to be unfair.

The Insurance Council submits that such an approach to the law is deeply flawed; a law should be drafted as it is meant to be enforced. This view of how UCT protections would be applied to insurance contracts also ignores that most consumer disputes for general insurance don't involve legal action but are adjudicated by the Financial Ombudsman Service (FOS – soon to be the Australian Financial Complaints Authority (AFCA)). With the monetary limit on disputes coming before AFCA set at $1 million[29], Insurance Council members need to take account of the very real possibility that FOS will find an exclusion void in order to reach a settlement that it considers to be fair in all the circumstances[30]; with this decision liable to be applied by FOS in all similar situations.

The Insurance Council and its members remain prepared to explore options of applying UCT provisions to insurance contracts which are acceptable to all stakeholders and allow consumers to challenge insurance contracts for unfairness while protecting the commercial basis on which they are underwritten.

30. Does the duty of utmost good faith in section 13 of the *Insurance Contracts Act 1984* (Cth) apply to the way that an insurer interacts with an external dispute resolution body in relation to a dispute arising under a contract of insurance? Should it?

Insurance Council key submission point:

- *In order to fulfil their obligation of Utmost Good Faith (UGF) to the insured, the insurer must interact with an EDR body in a manner consistent with this duty.*

Section 13(1) of the Act requires that each party to an insurance contract act towards the other party, in respect of any matter arising under or in relation to it, with the utmost good faith (UGF). Consequently, an insurer's conduct in the management of a dispute heard by an EDR body must be consistent with this duty.

[29] AFCA Draft Rules, c.1.2(e)
[30] FOS Terms of Reference 8.2 and AFCE Draft Rules A.14.2

31. Have the 2013 amendments to section 29 of the *Insurance Contracts Act 1984* (Cth) resulted in an "avoidance" regime that is unfairly weighted in favour of insurers? If so, what reform is needed?

Not addressed because it is a question which solely relates to life insurance.

32. Does the duty of disclosure in section 21 of *the Insurance Contracts Act 1984* (Cth) continue to serve an important purpose? If so, what is that purpose? Would the purpose be better served by a duty to take reasonable care not to make a misrepresentation to an insurer, as has been introduced in the United Kingdom by section 2 of the *Consumer Insurance (Disclosure and Representations) Act 2012* (UK)?

Insurance Council key submission points:

- *The duty of disclosure in section 21 of the Act continues to have a key role in informing insurers of the risks they are undertaking for commercial general insurance contracts. It would be inappropriate to replace it with a UK provision designed for retail insurance.*
- *In relation to retail sales of general insurance eligible contracts, adoption of the UK provision would not bring benefits to outweigh the disruption of a regulatory approach only adopted in 2013.*

The Insurance Council is responding to this question in regard to general insurance only. The current provisions in the Insurance Contracts Act dealing with the duty of disclosure result from the ALRC report which formed the foundation of the Act and the Cameron/Milne review of 2004. The duty of disclosure in section 21 of the Act applies to all contracts subject to the Act, where the insured elects to rely on the duty, while the application of the duty as specified in sections 21A and 21B relates only to eligible contracts of insurance i.e.:

- motor vehicle insurance;
- home buildings insurance;
- home contents insurance;
- sickness and accident insurance;
- consumer credit insurance;
- travel insurance; and
- other policies as may be notified by the insurer.[31]

The duty of disclosure as set out in section 21 therefore applies unaltered to general insurance of a commercial nature and retail policies not prescribed as eligible contracts.

[31] Insurance Contract Regulations 1985 2B. Notification as provided for under the last bullet point is used most commonly to provide uniform treatment as an eligible contract for policies of a composite nature.

As the UK Act cited only applies to consumer insurance contracts with non-consumer contracts subject to different provisions in the ***Insurance Act 2015 (UK)***, we presume that the Royal Commission is not suggesting that this change occur in relation to insurance taken out by commercial entities. It would be a significant change in approach to replace the duty of disclosure, which is well settled in Australian law, with a duty to take reasonable care not to make a representation to an insurer. We note that misrepresentations are already dealt with by Part IV Divisions Two and Three of the Insurance Contracts Act.

In relation to eligible contacts of insurance as prescribed, there may be only a minor difference between the effect of the UK provision and sections 21A and 21B. However, while several Australian general insurers no longer rely on the insured's duty of disclosure, most have designed their application and renewal policies for eligible contracts around sections 21A and 21B as amended in 2013. Without any benefit from switching to the UK approach being apparent, there does not seem to be merit in forcing disruption on the Australian general insurance sector and consumers.

H. REGULATION

33. Should the Life Insurance Code of Practice and the General Insurance Code of Practice apply to all insurers in respect of the relevant categories of business?

Insurance Council key submission point:

- *The Insurance Council is not opposed to making the GI Code mandatory for all insurers that issue products captured by the Code.*

The general insurance industry has a relatively mature and well developed industry code that has been in place since 1994. As at 31 January 2018, the proportion of the general insurance industry (excluding reinsurers) covered by the GI Code makes up 96.7 percent of the total General Insurance Gross Earned Premium. It is a condition of Insurance Council membership that members who provide products covered by the GI Code must adopt it.

The Insurance Council is not opposed if the Government considers that community expectations are such that entities engaged in activities covered by an industry code should be required to subscribe to that code. The GI Code currently covers the vast majority of providers of general insurance products and there are also a number of insurers who are not Insurance Council members who have voluntarily adopted the GI Code. While mandatory subscription may be of value for those financial services in which code participation is low, it is unlikely to make a material difference to consumers of general insurance products covered by the GI Code.

While we do not in-principle oppose requiring mandatory subscription to the GI Code, we are mindful that this may inadvertently result in entities other than issuers of general insurance products (and their authorised representatives) being required to adopt the GI Code; for example, insurance brokers and other distributors of general insurance, most of whom are already covered by other industry codes.

34. Should a failure to comply with the General Insurance Code of Practice or the Life Insurance Code of Practice constitute:

34.1. a failure to comply with financial services laws (for the purpose of section 912A of the *Corporations Act 2001* (Cth));

34.2. a failure to comply with an Act (for example, the *Corporations Act 2001* (Cth) or the *Insurance Contracts Act 1984* (Cth))?

Insurance Council key submission points:

- *A breach of the GI Code should not be treated as a breach of the law; such a change will impede industry efforts to strive for higher standards of self-regulation.*
- *The existing enforcement mechanisms under the GI Code are sufficient to address breaches of the Code.*

The Insurance Council does not support a change to the distinction between self-regulation and formal regulation such that a breach of an industry code becomes a breach of the law. We submit that this is unnecessary, given the existing enforcement mechanisms attached to the GI Code, and would create a barrier to the industry striving for higher standards of service.

The obligations under the GI Code, like other comparable financial services codes, are clearly enforceable through its governance structure. Insurers subscribe to the GI Code by way of a Deed of Adoption entered into between the insurer, the Insurance Council and the independent Code Governance Committee (CGC). As such, GI Code subscribers are bound to comply with the Code obligations and subject to CGC monitoring, enforcement and sanctions. The CGC is empowered to receive allegations about breaches; investigate alleged breaches; and determine whether a breach has occurred.

Sanctions enforceable by the CGC include requiring the Code signatory to take rectification steps (including compensating consumers); conduct a compliance audit; and publication of the non-compliance. To date, the CGC has not exercised its sanctions powers as corrective measures have been taken by Code signatories when breaches have occurred. The Insurance Council submits that this focus on correcting breaches, rather than on penalising Code signatories, is appropriate and fosters a cooperative and constructive approach to compliance.

The GI Code is also enforceable through the Financial Ombudsman Service (FOS); the FOS Terms of Reference provides that it can take into account industry codes in determining disputes.

We consider that the existing enforcement framework is comparable to codes that are prescribed by the ACCC, and where a breach of a code will also be taken to be a breach of the *Competition and Consumer Act 2010*. Where breaches occur, the ACCC is empowered to seek an injunction to prevent/require particular conduct or require compensation for loss as a result of the breach. In effect, this is comparable to the CGC's powers to require Code signatories to take corrective measures where a breach has occurred, and if the Code signatory fails to do this, to take rectification steps. We note that only two of the six prescribed codes enable the ACCC to issue civil penalties or infringement notices.

From our many years of experience in implementing, revising and enhancing the GI Code, we are of the view that the flexibility and adaptability of the Code is of paramount importance. The GI Code currently contains principles-based service standards that provides industry

with some flexibility in determining how they should comply. This is particularly important given the movement towards best practice standards for areas like family violence and mental health where continual progress by industry is better served in the form of more ambitious aspirational principles rather than prescriptive standards. Making a breach of the GI Code a breach of the law is likely to reduce the Code to minimum prescriptive standards. This would be a detrimental outcome for the industry as well as consumers.

35. What is the purpose of infringement notices? Would that purpose be better achieved by increasing the applicable number of penalty units in section 12GXC of the *Australian Securities and Investments Commission Act 2001* (Cth)? Should there be infringement notices of tiered severity?

Insurance Council key submission point:

- *The Insurance Council does not consider that any changes to the penalties regime, other than those recommended by the ASIC Enforcement Review Taskforce, are required.*

As noted in the recent ASIC Enforcement Review Taskforce's (the Taskforce) review into penalties for corporate and financial sector misconduct[32]:

> "Infringement notices are an allegation of a contravention of the law, payment of which causes the regulator to not pursue the alleged contravention any further. Payment of the notice also is not taken as an admission of guilt by the alleged offender. However, if the infringement notice is not complied with, ASIC remains entitled to bring other proceedings, civil or criminal, against the offending party."

Infringement notices are an alternative to criminal or civil penalty proceedings, and are intended to be used for less serious contraventions that can be more efficiently dealt with by an administrative penalty. The Taskforce found that infringement notices are beneficial because ASIC is able to take action in relation to a larger number of contraventions than it otherwise would be able to by way of legal proceedings, and thereby encourage voluntary compliance. We note that the infringement notice provisions are part of ASIC's broader toolkit including criminal and civil penalty provisions.

The Taskforce considered the interaction and quantum of different types of penalties enforceable by ASIC and recommended that infringement notices should be extended to a range of civil penalty offences under the Corporations Act. The Taskforce did not recommend increases to the quantum of penalty units for infringement notices under section 12GXC of the ASIC Act. The existing penalty units are consistent with the Attorney-General's Department "Guide to Framing Commonwealth Offences, Infringement Notices and Enforcement Powers". While financial penalties for infringement notices are lower than civil and criminal penalties, the Taskforce noted that the reputational effect of infringement notices can act as a deterrent and encourage compliance.

We do not consider that any other changes to the penalties regime are required.

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[32] ASIC Enforcement Review Taskforce (October 2017), *Strengthening penalties for corporate and financial sector misconduct*, consultation paper, p. 71.

I. COMPLIANCE AND BREACH REPORTING

36. Is there sufficient external oversight of the adequacy of the compliance systems of financial services entities? Should ASIC and APRA do more to ensure that financial services entities have adequate compliance systems? What should they do?

Insurance Council key submission point:

- *ASIC could provide guidance on aspects of compliance systems it considers to be best practice.*

ASIC and APRA undertake regulatory oversight activities quite differently, consistent with their different objectives and mandates and the size of their regulated population. Given, for general insurance, the issues explored by the Commission have focused on market conduct regulation, our comments focus on ASIC's oversight.

ASIC takes a risk-based approach to surveillance and enforcement, which is necessary given its wide regulatory mandate to have oversight of corporate and financial services conduct. The Insurance Council's experience of ASIC's risk-based approach is positive, which is illustrated in the amount of change ASIC has brought about in the motor dealer add-on insurance channel. ASIC's approach to identifying issues in the market, through obtaining data from industry to consumer research, was highly effective.

We anticipate that ASIC's ability to identify misconduct or conduct falling below community standards will become increasingly sophisticated. ASIC is prioritising developing expertise in data management, analytics and the application of new technology-based regulatory techniques and tools to become a more data-driven law enforcement agency[33]. Certainly, from a general insurance point of view, we have observed increasingly comprehensive data requests by ASIC, including individual policy level data through our engagement with ASIC on add-on insurance.

The industry would welcome guidance from ASIC about it expectations with regards to the adequacy of compliance systems. ASIC's everyday regulatory activities puts it in a good position to identify and advise industry on aspects of compliance systems that it considers to be best practice.

37. Should there be greater consequences for financial services entities that fail to design, maintain and resource their compliance systems in a way that ensures they are effective in:

    37.1. preventing breaches of financial services laws and other regulatory obligations; and

    37.2. ensuring that any breaches that do occur are remedied in a timely fashion?

Insurance Council key submission point:

- *Further regulatory change, other than the strengthening of penalties as recommended by the ASIC Enforcement Review Taskforce, is not required.*

[33] ASIC's Corporate Plan 2017-18 to 2020-21.

The Insurance Council considers that the strengthening of financial services conduct penalties as recommended by the ASIC Enforcement Review Taskforce (Taskforce) will provide a strong deterrent to prevent breaches from occurring. The ASIC-administered legislation already contains wide-ranging criminal offences and civil contraventions. The Taskforce has recommended substantial increases to penalties, including:

- increases to the maximum penalties for criminal offences in ASIC-administered legislation, with the most serious contraventions attracting up to 10 years imprisonment; and
- increases to the maximum civil penalty amounts in ASIC-administered legislation for corporations to the greater of $10.5 million, three times the value of benefits obtained or losses avoided, or 10 percent of annual turnover in the 12 months preceding the contravening conduct (but not more than $210 million).

These are substantial increases to the existing quantum of penalties, where the significant potential financial impact of breaching the law will act as a strong deterrent to misconduct. Treasury has released exposure draft legislation to implement these changes[34].

In addition to the increases to the quantum of penalties, the range of misconduct where civil penalties could be applied will be extensively expanded. This would provide ASIC with a choice of criminal or civil proceedings for the same conduct, which would give the regulator greater flexibility in penalising misconduct. Also, new disgorgement remedies would enable ASIC to seek orders requiring payment of an amount representing any profit gained as a result of the misconduct.

We also note that the Taskforce's recommendations on reforms to the breach reporting rules as well as empowering ASIC to give directions will strongly encourage breaches to be remedied in a timely fashion. In light of this, the Insurance Council does not consider further regulatory change is required.

38. When a financial services entity identifies that it has a culture that does not adequately value compliance, what should it do? What role, if any, can financial services laws and regulators play in shaping the culture of financial services entities? What role should they play?

Insurance Council key submission point:

- *An entity's Board should set expectations about behaviour that is acceptable.*

Financial services laws and the behaviour of regulators reflect the community expectations of the society within which they operate, and are influential in shaping the culture of a financial services entity. However, the culture of the entity is very much the result of expectations set by its Board as to acceptable behaviour. It is essential that the entity review and modify those expectations if legal compliance is not being given sufficient weight.

Given the increasing regulatory scrutiny of corporate culture, regulators may be in a position to share insights around good programs they observe.

[34] Treasury Laws Amendment (ASIC Enforcement) 2018 Bill.

39. Are there any recommendations in the "ASIC Enforcement Review Taskforce Report", published by the Australian Government in December 2017, that should be supplemented or modified?

Insurance Council key submission point:

- *The Insurance Council recommends that consideration is given to the provision of more practical ASIC guidance to assist licensees in complying with the breach reporting regime.*

The Insurance Council broadly endorses the recommendations of the Taskforce, which will substantially enhance ASIC's regulatory toolkit.

The Taskforce has recommended reforms to the breach reporting framework to enhance clarity around when an AFS licensee should report a breach. In the Insurance Council's submission[35] to the Taskforce, we noted that the regime could be made more effective if ASIC provided more practical guidance, such as:

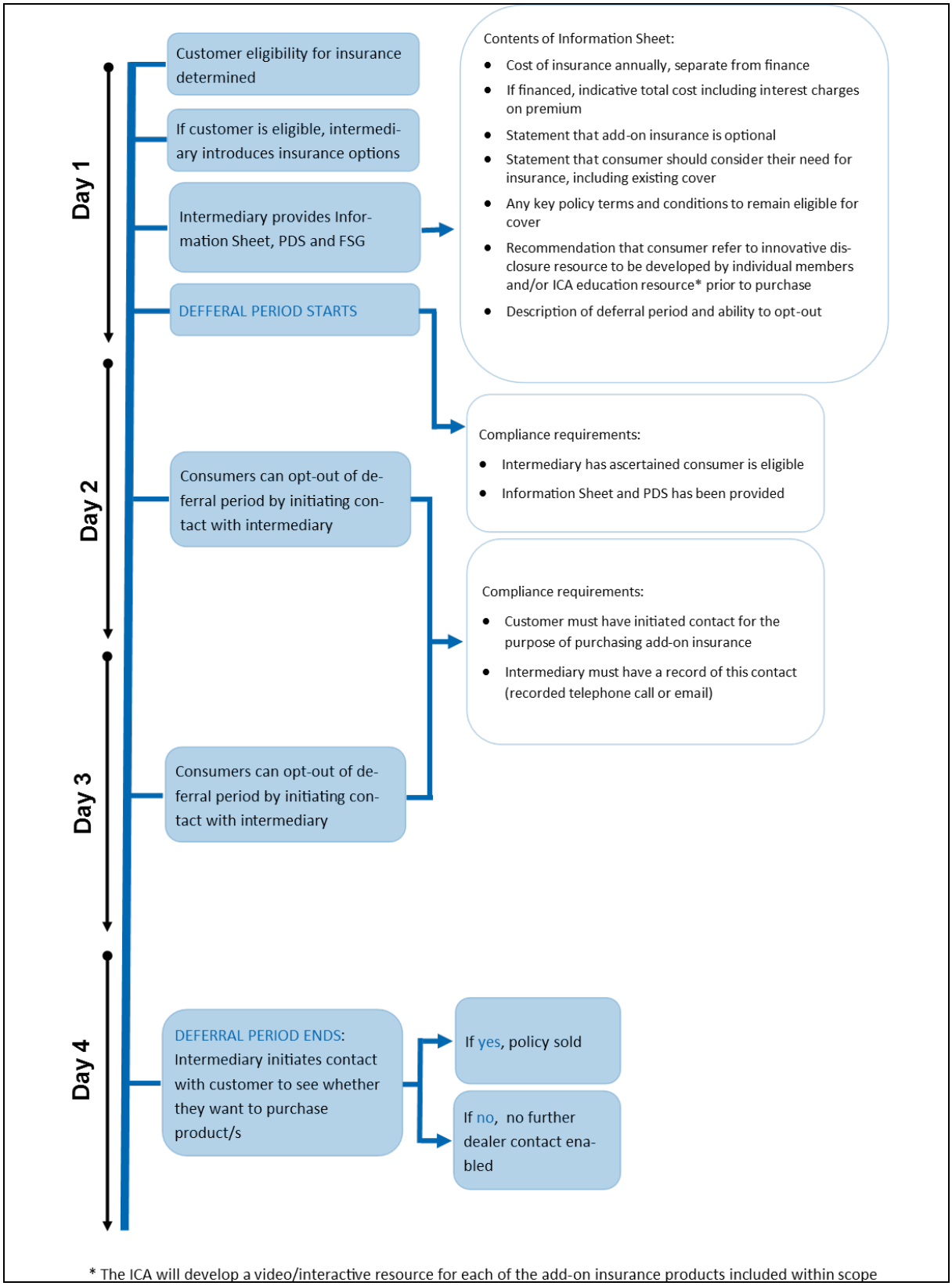
- objective metrics licensees could use in determining whether a breach should be reported; and
- examples of breaches ASIC considers to be significant.

The Insurance Council recommends that consideration is given to the provision of more practical guidance to assist licensees.

[35] Insurance Council (May 2017), *Self-reporting of contraventions by financial services and credit licensees*, submissions to ASIC Enforcement Review Taskforce, http://www.insurancecouncil.com.au/assets/submission/2017/2017_05_19_ASIC%20Enforcement%20Review_ICA_Breach%20reporting.pdf

INSURANCE COUNCIL OF AUSTRALIA

ATTACHMENT 1 – A Deferred Sales Model for Add-on Insurance



* The ICA will develop a video/interactive resource for each of the add-on insurance products included within scope

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