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

Round 6 Hearing – Insurance

Closing Submissions

POLICY QUESTIONS ARISING FROM MODULE 6

Introduction

1. These submissions are provided by the Commonwealth Bank of Australia (**CBA**) and its associated Australian entities (**Group**) and respond to the introductory question concerning the current regulatory regime, together with Topics F and H of the policy questions arising from Module 6.

2. The topic headings used by Counsel Assisting have been adopted in these submissions for ease of reference.

3. In September 2017, CBA announced the sale of its Australian and New Zealand life insurance business to AIA Group Limited (**AIA**).[1] The transaction has not yet completed.

4. In June 2018, CBA announced the strategic review of the Group's general insurance business, including a potential sale of that business[2].

5. In circumstances where the AIA transaction has not yet completed and the Group is still in the process of conducting its strategic review of its general insurance business, CBA has elected not to provide a response to the policy questions outlined by Counsel Assisting concerning life and general insurance.

6. The questions raised in Topic F (Insurance in Superannuation) have been responded to on behalf of the Group by Colonial First State Investments Limited (**CFSIL**), while the issues raised in Topic I (Compliance and Breach Reporting) cross-over to a large extent with compliance and regulatory questions that will be addressed as part of the Group's response to the Interim Report of the Royal Commission.

[1] https://www.commbank.com.au/guidance/newsroom/ASX2-201709.html?ei=card-view

[2] https://www.commbank.com.au/guidance/newsroom/demerger-of-wealth-and-mortgage-broking-businesses-201806.html

Introductory section

Question 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?

7. The general and life insurance industries in Australia are subject to a broad range of regulation, including consumer protection legislation. In particular, many types of contracts of insurance are subject to the *Insurance Contacts Act 1984* (Cth), an important piece of legislation with a number of consumer protection mechanisms. The Insurance Contracts Act has been reviewed and, in 2013, amended to enhance further its regime to minimise consumer detriment.

8. In the last 5 years, the life insurance industry has been the subject of a number of reviews and inquiries. For example:

   (a) over the period 2013[3] to 2018, industry-wide reviews by the Australian Securities & Investment Commission (**ASIC**) into sales (for example, to understand the advice consumers receive in relation to life insurance) and claims handling in the life insurance industry;[4]

   (b) over the period 2014 to 2015, an industry-led review commissioned by the Association of Financial Advisors and the Financial Services Council - concerning life insurance advice and the structure of remuneration for financial advisors;[5] and

   (c) inquiries by the Productivity Commission (into superannuation) and Parliamentary Joint Committee on Corporations and Financial Services (into the life insurance industry).[6]

9. Similarly, the general insurance industry has, in the last 15 years, seen reviews into:

   (a) from 2003 to 2004 - the Insurance Contracts Act;[7]

[3] See https://asic.gov.au/about-asic/news-centre/find-a-media-release/2014-releases/14-263mr-higher-standards-needed-for-life-insurance-industry/

[4] *ASIC report 413 - Review of retail life insurance advice* (9 October 2014), *ASIC report 498 - Life insurance claims: An industry overview* (12 October 2016) and *ASIC report 587 - The sale of direct life insurance* (30 August 2018).

[5] *Trowbridge Review on Retail Life Insurance Advice* (26 March 2015).

[6] *Productivity Commission Inquiry into Superannuation: Assessing Efficiency and Competitiveness* (Draft Report released on 29 May 2018) and *Parliamentary Joint Committee on Corporations and Financial Services: Inquiry into the life insurance industry* (27 March 2018).

(b) from 2005 to 2006 - smash repair and insurance;[8]

(c) over the period 2007 to 2014 - home insurance;[9]

(d) claims handling (for motor vehicle insurance policy claims lodged in the period 1 January 2009 to 31 December 2009);[10]

(e) from 2014 to 2016 - product features and sales;[11]

(f) in 2015 - financial product disclosure matters in insurance;[12] and

(g) from 2013 to 2017 - the industry more broadly.[13]

10. As a result, there are presently a number of reforms to general and life insurance currently proposed or being implemented.[14] The reforms have particularly targeted consumer protection, for example consumers' interaction with insurers during application processes and claims handling, the distribution channels of insurance products, and insurers' product design and disclosure obligations.

11. CBA considers that the current suite of reforms should be given time to embed, or proceed through the relevant consultation and legislative processes, before consideration is given to whether the current regulatory regime should be changed further to minimise consumer detriment.

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[7] *Review of the Insurance Contracts Act 1984 (Cth)*, A. Cameron and N. Milne (2005).

[8] See *Productivity Commission Inquiry into Smash Repair and Insurance* (18 August 2005).

[9] *ASIC report 89 - Making home insurance better* (25 January 2007), *ASIC report 415 - Review of the sale of home insurance* (28 October 2014) and *ASIC report 416 - Insuring your home: Consumers' experiences buying home insurance* (28 October 2014).

[10] *ASIC report 245 - Review of general insurance claims handling and internal dispute resolution procedures* (10 August 2011).

[11] *ASIC report 424 - Review of no-claims discount schemes* (26 February 2015) and *ASIC report 492 - A market that is failing consumers: The sale of add-on insurance through car dealers* (12 September 2016).

[12] *Insurance Council of Australia Effective Disclosure Task Force: Too Long; Didn't Read: Enhancing General Insurance Disclosure* (October 2015).

[13] *Financial Systems Inquiry* (7 December 2014) and *Senate Economics References Committee: Australia's general insurance industry: sapping consumers of the will to compare* (10 August 2017).

[14] See, for example, discussion in the Treasury paper *Background Paper 27: Request for Information: Reforms to General and Life Insurance* (28 August 2018) prepared for the Financial Services Royal Commission.

Topic F: Insurance in Superannuation

Question 23: Should universal:

- ***minimum coverage requirements; and/or***
- ***key definitions; and/or***
- ***key exclusions,***

be prescribed for group life policies offered to MySuper members?

12. CFSIL is supportive of universal changes that would promote simplicity, consistency and comparability for members.

13. Designing insurance arrangements for a fund can be a complex process with the need to consider a range of factors including terms and conditions (such as definitions and exclusions), the claims and experience of the fund and affordable and sustainable premiums for members. The trustee must balance these competing variables to provide the best outcome for its members.

14. CFSIL is of the view that these changes need to be done thoughtfully and with care in order to prevent inadvertent consequences that may be to the detriment of members and funds. For example, prescribing all of the terms listed above may potentially lead to some negative member outcomes, such as:

    (a) removing the ability for a trustee to provide a default insurance offering that is most appropriate for its membership base;

    (b) limiting the trustee's ability to control the level of premiums charged (and therefore the erosion of retirement benefits) by amending terms, leaving a reduction of default cover as the only mechanism to reduce premiums;

    (c) if prescribed terms are significantly broadened relative to current offerings in the market, this could result in significant premium rate increases; and

    (d) any future changes to the prescribed terms would automatically trigger a premium rate review for all funds.

15. CFSIL is of the view that no further change is required and considers that the changes proposed to insurance in superannuation in the Federal Budget (if legislated) would significantly impact member coverage.

16. CFSIL would support a level of universally prescribed exclusions where low levels of variability exist in the market and where universally prescribed exclusions would not significantly impact the overall structure of the insurance offering. This may include exclusions in relation to self-inflicted injury or war.

Question 24: Should group life insurance policies offered to MySuper members be permitted to use a definition of "total and permanent incapacity" that derogates from the definition of "permanent incapacity" contained in regulation 1.03C of the Superannuation Industry (Supervision) Regulations 1994 (Cth)?

17. CFSIL is supportive of simplifying definitions to promote greater simplicity and support members' understanding of how and when these definitions may apply.

18. In CFSIL's view, the industry would need to undertake analysis of the impact of being unable to derogate from the definition of "permanent incapacity" contained in regulation 1.03C of the *Superannuation Industry (Supervision) Regulations 1994* (Cth).

19. Definitions based on a member's employment status or number of hours worked, have traditionally been used as a mechanism for managing higher risks within the portfolio and, ultimately, premium rates, along with the erosion impact on member account balances. Providing all cohorts of members with the "permanent incapacity" definition, irrespective of employment status, may lead to a significant increase in premium rates for group policies. For this reason, industry may wish to understand the potential premium rate impact of such a change on members.

20. Whether derogation is permitted or not, CFSIL supports an approach that ensures members receive appropriate disclosure with respect to their "total and permanent capacity" definition and have easily accessible mechanisms to cancel or reduce cover, based on their individual circumstances. Some of the standards from the Insurance in Superannuation Voluntary Code of Practice (**Code**) will help promote and raise greater awareness of member benefits available under insurance policies.

Question 25: Should RSE Licensees be obliged to ensure that their members are defaulted to statistically appropriate rates for insurance required to be offered through the fund under section 68AA(1) of the Superannuation Industry (Supervision) Act 1993 (Cth)?

21. CFSIL supports the proposition that RSE Licensees should be obliged to ensure their members are defaulted to statistically appropriate insurance rates. Members should

not be defaulted to a category that applies higher premium rates than the general population (for example, smoker rates versus generic rates).

22. However, CFSIL acknowledges that there may be circumstances in particular insurance designs where a certain level of cross-subsidisation may be appropriate. For example, where a fund does not collect and record information related to occupation type (such as white or blue collar), it may be appropriate for a generic rate to be applied.

Question 26: Should RSE Licensees be prohibited from engaging an associated entity as the fund's group life insurer?

23. No. For the reasons discussed below, CFSIL is of the view that RSE Licensees should not be prohibited from engaging an associated entity as the fund's group life insurer.

24. CFSIL considers that related party dealings where conducted on an arms-length basis, entered into honestly, with due care, skill and diligence, for a proper purpose and in the best interests of members, should not cause concern or impinge upon the trustee's ability to comply with its fiduciary obligations.

25. A trustee of a superannuation fund has statutory and general law obligations to give priority to the interests of members over those of any other person and to act in the best interests of members. If the trustee is acting properly and in accordance with its duties (and assuming that there are appropriate risk management arrangements in place), then the appointment of an insurance provider who is a related party should not prevent the trustee from being able to satisfy its duties.

26. A superannuation trustee has an obligation to ensure that it has appropriate policies and procedures in place and is operating effectively to control any circumstances that may put it in a position of conflict with the interests of its members. Such measures include recognising and managing any conflict that may arise by negotiating the terms and conditions of the insurance policies at arms-length.

27. Critical to determining if a policy has been negotiated on arms-length terms is that the terms are commercial in nature and, where possible, independently supported (e.g. through benchmarking by external consultants). The arms-length nature of the arrangement must also continue through the life of the relationship, including the approach to monitoring the insurer, dealing with breaches of agreements or service standards and reviewing declined claims.

28. Fundamentally, business structures must also support the approach to the management of conflicts. Added to this is the heightened governance and professional approach arising from the appointment of majority independent boards for superannuation trustees. In a typical vertically integrated structure which includes both a superannuation trustee and a life insurer, it is usual for business, management and board structures to be maintained separately and according to distinct sets of business objectives and strategies.

Question 27: Alternatively, should RSE Licensees who engage an associated entity as the fund's group life insurer be subject to additional requirements to demonstrate that the engagement of the group life insurer is in the best interests of beneficiaries and otherwise satisfies legal and regulatory requirements, including the requirements set out in paragraphs 22 to 24 of Prudential Standard SPS 250, Insurance in Superannuation?

29. Whether or not the fund's group life insurer is an associated entity, CFSIL is of the view that conducting a market tender every 5 to 7 years could be recommended as best practice to assist in ensuring that any conflicts or perceived conflicts are managed, and the insurer selected is in the best interest of beneficiaries. This would further strengthen the implementation of trustee obligations under existing legislation and prudential standards.

30. In addition, where a market tender is not conducted, CFSIL is of the view that the RSE Licensee should be required to perform regular benchmarking across a range of criteria including product terms and conditions, such as definitions and exclusions, and premium rates offered by the insurer to ensure the existing insurance arrangements remain in the best interest of beneficiaries. Further, regulators could consider recommending a standardised set of criteria that funds could utilise for such benchmarking purposes.

Question 28: Are the terms set out in the Insurance in Superannuation Voluntary Code of Practice sufficient to protect the interests of fund members? If not, what additional protections are necessary?

31. CFSIL agrees with the objectives of the Code to set minimum standards and support consistency across the industry.

32. Combined with the proposed Federal Budget changes CFSIL expects this to have a significant impact on how insurance is offered through superannuation funds. The overall impact of these changes is yet to be determined but at a minimum, CFSIL

expect a significant increase to both insurance premium rates and the cost of administering insurance within the superannuation fund.

33. As the proposed changes are significant and yet to be implemented, CFSIL is of the view that some time should be allowed to lapse post implementation in order to appropriately assess member impacts before considering whether any additional protections are necessary.

Topic H: Regulation

Question 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?

Purpose of infringement notices

34. The issuance of an infringement notice is an administrative action that ASIC can take against financial services providers for contraventions of the *Australian Securities and Investments Commission Act 2001* (Cth) (**ASIC Act**) (unconscionable conduct and consumer protection provisions). Generally speaking, these notices are intended to facilitate payment of relatively small financial penalties in relation to relatively minor contraventions.[15]

CBA's view on extending the infringement notice regime

35. The appropriateness of infringement notices and proposed expansion of infringement notice regimes were examined during the ASIC Enforcement Review.

36. Recommendation 44 of the ASIC Enforcement Review Taskforce (outlined in the December 2017 report) supports the implementation of an expanded list of infringement notice provisions in the *Corporations Act 2001* (Cth), *National Consumer Credit Protection Act 2009* (Cth), National Consumer Credit Code and the *Insurance Contracts Act 1984* (Cth).

37. The Government has agreed to, or agrees in principle, to all the recommendations of the Taskforce and has completed consultation on draft legislation to implement these recommendations, including Recommendation 44.[16]

[15] https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/WhiteCollarCrime45th/Report/c05

[16] https://static.treasury.gov.au/uploads/sites/1/2018/09/T328482_Explanatory_Materials.pdf

38. The banking industry has fully cooperated with the ASIC Enforcement Review and broadly speaking, has supported the changes. While some of the reforms are still being implemented, taken together they reflect a substantial change to ASIC's capabilities and if utilised effectively, this could have a material impact on how ASIC delivers on its mandate. Moreover, CBA is committed to cooperating with regulators to prevent misconduct and draw matters of potential misconduct to the regulators' attention at the earliest opportunity.

39. CBA notes concerns from industry bodies, including the Financial Services Council, regarding the use of infringement notices for contraventions that have subjective or evaluative content.[17] Following implementation of the reforms under the ASIC Enforcement Review, we welcome an assessment to determine whether these concerns have been resolved.

40. CBA does not consider that the purpose of infringement notices would be better achieved by increasing the number of penalty units in section 12GXC of the ASIC Act or the introduction of infringement notices of tiered severity. As part of Recommendation 45, the ASIC Enforcement Review Taskforce recommended that infringement notice amounts should generally be set at the prescribed maximums in the Attorney-General's Department Guide to Framing Commonwealth Offences, Infringement Notices and Enforcement Powers: 12 penalty units for individuals and 60 penalty units for corporations. The ASIC Enforcement Review Taskforce maintained the view that 12 and 60 penalty units is the appropriate measure.

25 October 2018

[17] https://static.treasury.gov.au/uploads/sites/1/2017/12/FSC.pdf (Page 14)