SUNCORP

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The Honourable Kenneth Madison Hayne AC QC
Royal Commission into Misconduct in the
Banking, Superannuation and Financial Services Industry
Bourke Place
600 Bourke St
MELBOURNE VIC 3000

Via email: FSRCSolicitor@royal.commission.gov.au

25 October 2018

Dear Mr Hayne,

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

I refer to the policy questions released by the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (the "**Commission**") on 27 September 2018, which sets out the policy questions arising during Round 6 – Insurance.

AAI Limited (**AAI**), the licensee of Suncorp's general insurance business, welcomes the opportunity to provide a written submission in response to the policy questions.

AAI is one of the largest providers of general insurance in Australia and has always been active in public policy debate, engaging with government, regulators and independent inquiries about ways in which Australians can have access to affordable insurance to help them better manage the risks they face throughout their lives.

Australia's exposure to risk, particularly natural hazards, continues to increase. During the last decade, many parts of Australia have seen an increased natural hazard exposure and when events occur, communities can be devastated, economies hurt and government budgets affected.

In this context, while risk is unavoidable, the impact of events can be reduced and managed. As an insurer, AAI takes its role in the lives of its customers seriously. Its vision is to be there for its customers in the moments that matter.

Australian consumers want access to general insurance products that are easy to understand and fulfil their purpose. For insurers to be able to provide these products to consumers effectively, the regulatory environment must facilitate clear and accessible communication and disclosure to consumers. As such, the focus in any consideration of regulatory change in the general insurance industry should be on simplifying and streamlining aspects of the existing regulatory regime, rather than adding further overlapping obligations. Any proposed regulatory change must be stress-tested for its potential to impact the prudential resilience of the Australian insurance industry and its ability to remain sustainable, highly competitive and efficient, such that it can continue to meet the expectations of the Australian community that they have access to affordable cover.

AAI notes that the scope of a number of questions goes beyond the general insurance industry. This response is limited to questions that relate to issues which impact AAI's business directly, that is, to issues impacting the general insurance industry. AAI's responses should not be taken as AAI or Suncorp's views on issues more broadly (i.e. beyond general insurance). Further, as noted by Counsel Assisting during the Round 6 hearings, Suncorp's Australian life insurance business has been sold to TAL Dai-ichi Life Australia Pty Limited and, once APRA approval has been given for a cessation date, no Suncorp entity within Australia will manufacture life insurance products. As such, this response does not address questions which solely relate to the life insurance industry.

Yours sincerely

Gary Dransfield

CHIEF EXECUTIVE OFFICER,
INSURANCE

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

ROUND 6 – INSURANCE

RESPONSE TO POLICY QUESTIONS ON BEHALF OF AAI LIMITED

Q1 *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?*

1. AAI has had the benefit of reviewing the proposed response of the Insurance Council of Australia (**ICA**) to these questions (**ICA response**) and generally endorses its response to this question. In particular, AAI endorses the ICA's comments regarding simplification of the statutory regime protecting general insurance customers.

2. The key goal of the regulatory regime is to minimise customer detriment and therefore a number of the issues addressed in the questions below have a bearing on this question. AAI's views on the specific issues are set out below.

POLICY DESIGN

Q2 *Are there particular products – like accidental death and accidental injury products – which should not be sold?*

3. AAI endorses the ICA response to this question, and emphasises the role that the incoming design and distribution obligations (**DDO**) regime and associated ASIC powers will play in ensuring that products are appropriate for the needs of consumers.

DISCLOSURE

Q4 *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.)

Q5 *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?*

Q6 *Is there scope for insurers to make greater use of standardised definitions of key terms in insurance contracts?*

4. The purpose of disclosure is, appropriately, to ensure that consumer expectations about a particular insurance product are in line with the way in which the product actually operates, so as to ensure that customers are obtaining the most appropriate insurance cover for the risk under consideration. As such, the focus of any regime should be on ensuring that disclosure is effective, meaning that consumers are provided with information in a format that they can easily understand (whether in multi-lingual, verbal, video or pictorial form, or otherwise).

5. As noted in the ICA's response to Question 4 (which AAI supports), there are many components to the mandatory disclosure regime as it relates to general insurance products, including:

   (a) *Chapter 7 of the Corporations Act 2001* (Cth) (**Corporations Act**), which prescribes a long-form Product Disclosure Statement for general insurance products;

   (b) insurance-specific requirements under the *Corporations Regulations 2001* (Cth) (**Corporations Regulations**);

   (c) separate disclosure obligations set out in the standard cover regime of the *Insurance Contracts Act 1984* (Cth) (**Insurance Contracts Act**) (Division 1 of Part V of the Insurance Contracts Act, in particular ss 35 and 37); and

(d) various other disclosure requirements under the Insurance Contracts Act, including obligations in respect of particular types of cover (Division 1A and Division 2 of Part V) and particular modes of disclosure, such as Division 4 of Part IV, which requires the preparation of Key Fact Sheets for home insurance products that must list prescribed events and the cover provided for those events.

6. The breadth and complexity of these requirements has led to lengthy documents which, combined with the technical nature of insurance terminology, have resulted in ineffective disclosure.[1] This represents a marked failure against the intended purpose of the disclosure regime.

7. AAI considers that the current regime for mandatory disclosure is overly complex, and the focus should be on the simplification of the existing law rather than the addition of a new layer of regulation. In doing so, the guiding principle should be on 'effective disclosure' – that which is most useful and relevant to the customer at that point in time. Recent research shows that consumers do not read current forms of disclosure material, and do not make good decisions even if they do so. This was highlighted by a recent paper released by Monash University regarding the mandatory disclosure regime,[2] which concluded that:

(a) there are doubts about the effectiveness of mandated disclosure in nudging consumers towards making rational insurance product choices – even in the most ideal of circumstances. The study notes that even in idealised circumstances where consumers are provided Key Fact Sheets for making a simple choice between a good and a bad product, relatively little time is spent reading the documentation and there has been no systematic increase in the number of consumers who will purchase the good product; and

(b) the mandated disclosure information does not reliably assist consumers in making better purchase decisions. Nor does it appear to do a great deal to optimise their chances of obtaining suitable insurance cover.

8. In this regard, AAI notes that inadequate functional literacy on the part of many Australians means that they cannot read and understand the information that the mandatory regime requires insurers to disclose,[3] with consequences for their ability to make an informed decision about whether an insurance product provides the level of cover they need. This is all the more significant in circumstances where (as the ICA response notes) for general insurance products the PDS does not only provide information about the product, but sets out the contractual terms of the product itself.

9. In particular, the standard cover regime is now outdated. The standard cover regime was introduced in 1984, before the introduction of the mandatory disclosure regime in Chapter 7 of the Corporations Act. It requires the inclusion of certain prescribed terms of cover in a contract of insurance unless the insurer specifically draws the insured's attention to any derogation from the standard cover terms.[4] Under s 35 of the Insurance Contracts Act, an insurer can only derogate from the standard cover if the insurer "clearly informed the insured in writing" that the relevant cover was excluded or varied. The purpose of the regime was to ensure that consumers were aware of exclusions and limitations in a policy they are considering, which made sense in an environment that did not have more prescriptive disclosure requirements. The regime was successful for a period, but additional regulation has since been overlaid, and over time the market has moved away from basic products to more tailored product structures and coverage to meet the needs of current and emerging customer segments such that few insurers now offer products in the form of standard cover. These developments have reduced the effectiveness of the regime, as has the fact that it has remained largely unchanged since it was introduced.

10. AAI considers that the inclusion of exclusions or limitations on standard cover in a disclosure document is generally ineffective in bringing the fact that it is a derogation from a statutory regime of standard cover to a customer's attention. As noted in the ICA response, Treasury is conducting a review in this area and the ICA is proposing a second phase of consumer research which will consider aspects related to this issue. AAI welcomes both of those reviews, and will actively participate and consider this issue upon their completion.

11. To make disclosure more effective there may be scope for insurers to make greater use of standardised key terms or definitions in contracts to provide clarity and certainty to consumers and make products more comparable for consumers. Any standardisation initiatives will need to consider what past precedent may be lost in moving away from terminology that is well established in insurance law jurisprudence. As noted in the ICA response, the ICA's second phase of research coming out of its Effective Disclosure Taskforce will also consider the role of standard terms. AAI looks forward to considering the results of that research to determine whether consumers could benefit from the introduction of more standardised terms.

1 See section 4 of the ICA submission to the Royal Commission dated 5 February 2018, which sets out the past reviews and inquiries in relation to this issue, together with ICA report Too Long; Didn't Read – Enhancing General Insurance Disclosure, 2015.

2 Malbon, J. & H. Oppewal. (2018), "(In)effective disclosure: An experimental study of consumers purchasing home contents insurance." Monash Business School and Monash Faculty of Law, research report of a study commissioned by the Financial Rights Legal Centre. Available from **https://australiancentre.com.au/wp-content/uploads/2018/09/InEffectiveDisclosure-final.pdf**. See also the findings in ASIC Report 415 Review of the Sale of Home Insurance (October 2014) and ASIC Report 416 Insuring your home: Consumers' experiences buying home insurance (October 2014) that most consumers do not read their disclosure documents before purchasing insurance.

3 ABS Adult Literacy Survey (2006-07), available: **http://www.abs.gov.au/AUSSTATS/abs@.nsf/Lookup/4102.0Chapter6102008** and OECD survey on Adult Skills (2013), available: **http://www.oecd.org/skills/piaac/Country%20note%20-%20Australia_final.pdf**.

4 Australian Law Reform Commission, December 1982, Insurance Contracts, (ALRC Report 20), paragraph [57], [60], available: **https://www.alrc.gov.au/report-20.**

12. In considering whether and which terms should be standardised for particular types of cover, care must be taken to ensure that the industry can remain flexible and competitive, permitting insurers to compete by providing innovative cover options to customers and deviating from standard definitions. Competition must be on more than price, and any standardised definitions must be set as a minimum standard, which can be improved upon. This is consistent with the current position in relation to flood cover: the definition of flood can be varied, but only if it benefits both consumers and insurers. Insurers should not be unduly restricted or prohibited from offering a better product or level of cover to their customers by a legislative regime which is designed to serve the benefit of customers. To do so would be contrary to the purpose of the regime.

13. In addition, the Commonwealth Government has recently introduced legislation to introduce DDO, which is intended to achieve a better alignment between customers' interests and the insurance cover they are offered. This will mean that products are designed, distributed and managed having regard to the particular target market.

SALES

Q7 *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?*

14. To the extent that any exemption from the conflicted remuneration regime for advice provided in respect of general insurance products is removed or carved back, the new regime should be designed with the specific nature of general insurance in mind, which retains unique characteristics that distinguish it from wealth and life insurance products (which are the products that Division 4 Part 7.7A of the Corporations Act was drafted to apply to). These unique features of general insurance products include:

    (a) policies are annually renewable – the customer is not locked in to a long-term commitment. This means that work may be performed by an adviser each year to assess the appropriateness of cover;

    (b) low barriers for switching policies. For example, in most general insurance products there are no "pre-existing" exclusions as are prevalent in some life products which, combined with the obligation of disclosure at the time of renewal, means that there is little detriment in switching between policies or insurers;

    (c) generally, new business commission is the same as the renewal commission with no material gap between them. This is an important distinction with many wealth and life products where there is higher upfront and lower trail commission paid; and

    (d) a highly competitive market, with more than 115 licensed insurers offering products and in which a number of distribution channels are open to the consumer to access insurance.

15. Removing the exemption in respect of general insurance, without a further consideration of the specific nature of advice in that market, could have unintended consequences which have not yet been identified. Key amongst AAI's concerns is that a ban on product commission payable to intermediaries where advice is given may make advice less accessible and affordable for the community. If advice was only paid for by the consumer with up-front fees, the expectation is that fewer consumers would seek advice.

Q10 *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?*

16. There is an important distinction to be made between unsolicited calls, which are a breach of anti-hawking legislation, and outbound calls which are made in response to clear and informed consent from customers and are designed to have a customer benefit, for example by reminding them of an upcoming renewal period. The regulatory regime in place in respect of outbound calls and, in particular, the consent requirement, is sufficient to balance any potential detriment with the value that calls of this nature have for consumers. Further, as noted in the ICA response, AAI is not aware of any concerns about the use of outbound telephone calls in the general insurance industry where prior consent has been obtained.

Q11 *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?*

17. AAI agrees with recommendation 10.2 of the Productivity Commission's report to rename 'General Advice' to avoid confusion on the part of consumers as to the nature of the advice being provided to them. More broadly,[5] AAI would welcome the investigation of the efficiency of the advice regime as it applies to the sale of insurance, which the ICA response also supports. [6] In this regard, AAI notes that the recently proposed DDO, which AAI supports in principle, will also assist in ensuring customers are sold the most suitable product.

5 Too Long; Didn't Read – Enhancing General Insurance Disclosure, 2015, page 52.

6 See also Too Long; Didn't Read – Enhancing General Insurance Disclosure, 2015, pages 50 to 52.

CLAIMS HANDLING

Q17 *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?*

Q18 *Should ASIC have jurisdiction in respect of the handling and settlement of insurance claims?*

18. To the extent this question proposes that the obligation under section 912A(1)(a) should extend to the handling and settlement of general insurance claims, AAI notes that there are a number of existing obligations on general insurers to their customers which ensure that they engage with them in an efficient, honest and fair manner. Most notable is the obligation under s 13 of the Insurance Contracts Act to act with the utmost good faith in respect of any matter arising under a contract of insurance, including claims handling. In addition to this, the General Insurance Code of Practice (**Code**) places obligations on insurers (and by extension, other individuals whose conduct is attributable to an insurer under the Code) to be open, fair and honest in their dealings with an insured (clause 1.3) and to conduct claims handling in an honest, fair and transparent manner (clause 7.2).

19. Section 912A of the Corporations Act applies to all aspects of the insurance process, except the handling or settlement of a claim in relation to an insurance product.[7] As such, any proposal to extend s 912A to the handling and settlement of claims (as suggested in Question 17), in conjunction with the question about ASIC's jurisdiction in the area (Question 18) necessarily raises considerations about the exemption for claims handling.

20. There were good policy reasons that led to the introduction of that exemption, which remain valid today. Principally, the regime was developed to address the advice required in respect of the sale of products. At its core, however, the value of an insurance policy is the ability to make a successful claim following an insured event (i.e. often well after the point of sale). It is at the point of claim (performance of the contract) that assistance from the insurer can be most critical to an insured, and under the current advice regime that assistance could result in advice being provided, which was not the intention of the requirements of the advice regime when it was designed.

21. AAI understands the impetus for reconsidering that position, but cautions that any change needs to be prefaced by careful consideration of the practical implications for the general insurance industry given the complex existing regulatory regime that applies to general insurance and, in particular, how it will impact the customer experience.

22. Pursuant to regulation 7.1.33 a financial service will not be provided for the purposes of the Corporations Act where a person:

    (a) gives advice that consists only of a recommendation or statement of opinion provided in the course of, and as a necessary or incidental part of, the handling of claims or potential claims in relation to an insurance product or the settlement of claims or potential claims in relation to an insurance product (**advice exemption**); or

    (b) engages in a dealing in an insurance product that is a necessary or incidental part of the handling of claims or potential claims or the settlement of claims or potential claims in relation to that insurance product (**dealing exemption**).

23. AAI does not oppose the removal of the dealing exemption, provided there are necessary measures in place to recognise the unique features of the general insurance industry. AAI does, however, oppose the removal of the advice exemption as it would have significant and detrimental impacts on the service levels that insurers will be able to provide to consumers (which is discussed further below).

Advice exemption

24. The advice exemption was originally implemented to allow for flexibility of conversation as insurers support customers through the claims process without being hindered by the more onerous obligations contained in Chapter 7 of the Corporations Act, an intention that is also reflected in the modified best interests duty in s 961B(4) of the Corporations Act. The examples set out in the regulation itself make it clear the intention was to allow claims staff to freely discuss all aspects of a claim with a customer to assist them in the process, for example, in providing estimates of loss and recommendations as to mitigation of loss. This justification remains true today and is essential to enable more favourable claims outcomes and resolutions for customers. Therefore, any consideration of the removal of the exemption needs to take into account the specific circumstances of claims handling in order to ensure that consumers are no worse off from the imposition of additional advice obligations.

25. The financial services advice regime was not developed with the particularities of the insurance industry in mind. The nature of the assistance given in respect of claims handling is such that, depending on how the conversation with a customer progresses, it could range from no advice, to general advice or personal advice. As such, claims handling staff would either need to be trained and licensed to provide personal advice, which would necessarily include training in relation to conducting a needs analysis and provision of documentation in relation to recommendations given, or they would need to ensure that any conversation they have does not amount to personal advice. The ultimate impact would be to prevent claims handling staff from engaging in effective and timely discussions with customers regarding claims.

7 By virtue of Regulation 7.1.33 of the Corporations Act.

26. The following are some examples of common conversations between claims handling staff and customers, which would be impacted by a change to the advice exemption:

    (a) in respect of motor vehicle claims, it is often the case that damage to an older vehicle (which is insured for a low amount, but has comprehensive cover to protect the customer in respect of damage to a third party vehicle) means that it is not economical to repair it and the outcome of an assessment process would be to treat it as a total loss. In that situation, a customer might prefer to keep the vehicle, which is still functional, instead of making the claim and only receiving a small amount for it. Claims handling staff may discuss those options with them;

    (b) there are instances in which it may be in the best interest of a customer to make a warranty claim (for example, manufacturer's warranty or builder's warranty), rather than to claim under their insurance policy, which may involve an excess payment and the risk of losing other associated benefits such as no-claim discounts. Customers may not have considered a warranty claim as a possible alternative and it is something that claims handling staff may bring to their attention in the claims notification phase;

    (c) where a claim is for a small amount, the excess payable for that item of cover under the policy may exceed the amount the customer would receive if a claim were to be made under the policy. Customers may ask claims handling staff whether it is in their interest to make a claim or may not even consider the fact that the excess could exceed the value of the claim, which claims handling staff may, under the terms of the advice exemption, bring to their attention;

    (d) in respect of total loss claims for home insurance, customers may seek guidance from claims handling staff in relation to their options (for example, rebuild or cash settlement), in circumstances where a customer may prefer to construct a different type of home to that which was insured and give consideration to their other financial obligations in doing so. This is even more so the case after a natural disaster event, when customers may want to leave the area and rebuild elsewhere, in which case a cash settlement is often their preferred option.

27. The increased training and potential licensing requirements for claims handling staff will also undercut the objectives of s 912A itself, specifically the requirement for services to be provided 'efficiently', and also the requirement for 'timely' conduct of claims under the Code as it could have one or more of the following consequences:

    (a) all staff who interact with customers in respect of claims would need to be trained to identify where a conversation may lead to the provision of advice and ensure that they do not respond to questions from customers which may have that result;

    (b) less frank discussions with consumers about their options in order to avoid the risk of providing personal advice or alternatively, increased documentation being prepared and provided to customers if advice is provided (which may compound the issues of consumer comprehension explained above in the context of disclosure documentation); and

    (c) impacting the ability of insurers to swiftly respond to natural disaster events by transferring staff from other parts of the business (who will not necessarily have the appropriate training) to assist with claims lodgement.

28. AAI is aware that customers who are making a claim on a policy are often experiencing challenging and stressful circumstances, such as those affected by a natural disaster, involved in a car accident or experiencing financial hardship. As such, it is imperative that they receive prompt and meaningful assistance rather than a constrained response (where no advice is provided) or potentially more extensive documentation (where advice has been provided). AAI is also cognisant that these customers do not want to speak to several customer service representatives to provide information about their claim several times and receive an outcome to their claim in a piecemeal fashion. Fragmentation of the claims handling process, between staff qualified to give different types of advice and those who are not, would remove single points of contact for customers, increase the risk of miscommunication, misunderstanding and delay from the perspective of both the customer and the insurer and would increase customer anxiety at a time of existing stress.

29. If the advice exemption was removed, it would have consequences throughout the life cycle of a claim and extend to vehicle smash repairers, builders and restorers, loss assessors (who assist customers to understand the extent of their loss) and other suppliers involved in the handling and settlement of claims who are not employed by the insurer. While many of these service providers are already subject to industry and/or state-based licensing regimes relevant to their profession or trade, these individuals would not be familiar with financial services law obligations. This may limit the willingness of these third parties to provide services to insurance companies, particularly in regional and remote areas of Australia if these third parties are required to comply with extended licensing obligations as a result of this proposed amendment, reducing the ability of insurers to meet the needs of customers in these areas.

30. While AAI would, of course, comply with any additional regulatory obligations imposed upon it, AAI notes that it will result in increased compliance costs (for example, training of claims handling staff in the provision of advice) which will ultimately impact the cost of insurance. This could potentially result in insurance affordability issues and ultimately underinsurance of consumers, with people either reducing their level of cover or deciding not to take out insurance at all.

Dealing exemption

31. It must be recognised, as noted above, that there are already existing and significant obligations on insurers as to the manner in which they deal with their customers, including throughout the claims handling and settlement processes. The concerns identified above in respect of the advice exemption also arise should there be any change to the dealing exemption, which could also result in licensing requirements for claims handling staff and third parties involved in fulfilling customer claims. Importantly, however, removal of the dealing exemption would also increase ASIC's regulatory reach in circumstances where such an extended jurisdiction would overlap with other current regimes. This impact needs to be carefully considered. Any regime will need to be tailored to the insurance industry before any change is implemented as it could have significant implications, which ultimately lead to a detrimental customer impact.

32. Key amongst the obligations on general insurers are:

    (a) the utmost good faith obligation under s 13 of the Insurance Contracts Act. ASIC has an explicit existing power under s 14A of the Insurance Contracts Act in relation to the handling or settlement of a claim or potential claim. As a result, ASIC has the ability to vary, suspend or cancel a licence and to make banning orders.

    (b) the consumer protection provisions of the *Australian Securities and Investments Commission Act 2001* (Cth) (**ASIC Act**). ASIC has powers under the ASIC Act that are not restricted by the exemption in regulation 7.1.33 and, as such, it would be open to ASIC to take action in respect of conduct in handling insurance claims which, in its view, was in breach of those provisions.

    (c) the Code obligations in clause 1.3 and clause 7.2. Compliance with these obligations can be enforced through the dispute resolution and oversight frameworks implemented by the Code which include the ability of individual customers to have disputes determined by the Financial Ombudsman Service (**FOS**) Australia (soon to be the Australian Financial Complaints Authority (**AFCA**)) and the ability of FOS to refer matters to ASIC for its consideration.[8] In addition:

        (i) the governance arrangements for FOS, which bind insurers in force of contract, give FOS the ability to expel an insurer from membership with consequences for the insurer's compliance with the licensing obligations under s 912A(2) of the Corporations Act and the regulatory consequences that flow from such a non-compliance; and

        (ii) the Code Governance Committee (**CGC**) has the ability to impose sanctions on Code subscribers if it determines there to be a breach of the Code and the insurer fails to implement the corrective measures identified in the determination. Those sanctions can include rectification programs, compliance audits, corrective advertising and naming and shaming.

33. ASIC's powers noted above are supplemented by ss 30 and 33 of the ASIC Act and s 11C of the Insurance Contracts Act which allow ASIC to compel the production of information or documents in relation to the conduct of insurers, including in relation to claims handling activities.

34. In addition, the role of APRA in the general insurance industry in Australia cannot be disregarded. APRA has clearly stated that efficient claims handling by insurers is key to the financial stability of the insurance sector.[9] APRA's focus is on the promotion of prudent claims handling processes that balance the interests of claimants in having their legitimate claim paid, and the interests of the community of other policyholders in the financial stability of the insurer, and in not having their premium increased to fund claims outside the terms and conditions of the policy. Any change to the regulation of claims handling activities that has a financial impact on insurers will be of concern to APRA as part of its focus on ensuring the prudential sustainability of insurance providers.

35. AAI considers that these existing obligations and the associated jurisdiction that regulators and industry bodies have in relation to those obligations provide sufficient protection for customers. In the absence of clear evidence that consumers would be better off, it is inappropriate to add a new layer of law or regulation as to do so will only increase compliance complexity and cost.

36. As explained above, if the dealing exemption is removed, there will need to be clearly defined roles and parameters applicable to each of the regulators' remit to avoid unnecessary and potentially harmful duplication. Without careful tailoring, there is a real risk of regulatory overlap, if not inconsistency, in enforcement priorities and action, which is inconsistent with the Commissioner's clear indication that the law needs to be simplified rather than multiplied.[10] Any amendment to the scope of the exemption needs to set clear parameters for the role of each regulatory body, provide for escalation pathways for the resolution of disputes in relation to individual claims and promote cooperation and coordination between regulators, not only in relation to the investigation of alleged misconduct but also in their efforts to gather information and data about the performance of the insurance sector more generally to ensure that there is not an undue regulatory burden.

8 AAI notes that FOS will soon be superseded by the Australian Financial Complaints Authority (AFCA), which will have expanded reporting triggers (see further Q34 below), but for the purposes of responding to this question has considered the current arrangement.

9 APRA Discussion Paper, May 2017, Towards a transparent public reporting regime for life insurance claims information.

10 Interim Report, page 290.

GENERAL INSURANCE

Q22 *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)?*

37. As explained above, the Code already has an overarching requirement that an insurer must act fairly in all dealings with a customer (clause 1.3) and a specific obligation to conduct claims handling in an honest, fair, transparent and timely manner (clause 7.2). Additionally, other frameworks require similar behaviours, for example, the obligation to act in utmost good faith under the Insurance Contracts Act. These obligations apply to all aspects of claim handling and settlement, including any decision to cash settle a claim.

38. In regards to ensuring that a policyholder is indemnified against the loss insured, this is the inherent function of a contract of insurance. An insurer is required to repair, rebuild, replace or cash settle in accordance with the terms of the contract. There is no need for an express provision in the Code that an insurer comply with its contractual obligations. The purpose of the Code is to set out expectations for the manner in which the insurer will comply with those contractual obligations. While there is no express requirement in the Code at present to the same effect, it is implied in the overarching duties identified above.

39. Therefore, if what is proposed is no more than an amendment to the Code to include a specific requirement that an insurer comply with the requirements within the limits of the policy when cash settling a claim, then AAI has no objection to that and considers that the Code already has that effect by virtue of the obligations noted above. However, if it is proposed that the Code be amended to require that any cash settlement be sufficient to cover "all necessary repairs", even where that would exceed the contractual limits and exclusions within a policy and amount to betterment, AAI considers that would be at odds with the underlying rationale of an insurance policy.[11] AAI is also concerned that such an amendment would lead to confusion on the part of consumers as to how a policy operates and ultimately, if insurers were required to offer amounts sufficient to cover "all necessary repairs" outside the terms of insurance, this would lead to less flexibility in pricing policies and less affordable insurance options for consumers. Ultimately, this would affect the entirety of the community of policyholders, including those who do not claim in a particular year.

SCOPE OF THE INSURANCE CONTRACTS ACT 1984 (CTH)

Q29 *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?*

40. AAI's position in relation to the extension of unfair contract terms protections to insurance contracts is set out in its submission to Treasury's consultation on 'Extending Unfair Contract Terms Protections to Insurance Contracts' in August 2018.[12]

41. Notwithstanding AAI's view that the extension of unfair contract terms to general insurance is unnecessary due to the existing strong protections under existing regulation, if this reform is to proceed, it is AAI's view that it is essential any regime does not adversely impact the availability of affordable and accessible insurance products for its customers and the broader community. AAI is keen to ensure the proposed reforms are workable, do not impose an unreasonable compliance burden, and do not result in the limitation of choice for consumers.

Q30 *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?*

42. Even when dealing with an external dispute resolution body (**EDR**), an insurer continues to have an obligation to comply with the duty of utmost good faith towards the insured. Section 13 of the Insurance Contracts Act requires an insurer to act towards an insured in respect of any matter under or in relation to the policy, with utmost good faith. That clearly includes the manner in which the insurer conducts itself when dealing through the EDR body, which directly impacts the insured.

11 Contracts of general insurance generally provide for reinstatement, that is, putting the policyholder back into the same position they were in before the insured event caused the loss now subject to the claim. It is to be contrasted with betterment, which involves the improvement of the underlying insured property to a state above its original condition.

12 SUN.1610.0002.0001; Exhibit 6.370.1.9.

43. In addition to that, the terms of the relationship between AAI and the EDR body[13], are governed by the AFCA Rules, which were approved by ASIC in September 2018. The rules form a contract between AFCA and its members. Under the Rules:

    (a) A party to a complaint is required to provide AFCA with information AFCA considers necessary to make a decision (Rule A.9.1);

    (b) AFCA may also require a party to a complaint to do anything it considers may assist it, including attend an interview or to appoint an independent expert (Rule A.9.3); and

    (c) Where a party fails to provide that information, AFCA may take whatever steps it considers necessary, including making a decision without that information, on the basis that an adverse inference can be drawn from the party's failure to provide the information (Rule A.9.5).

44. The Guidelines to the AFCA Rules also indicate that a breach of membership obligations may be referred to the AFCA Board, with a view to expelling the member. The Guidelines also indicate that expulsion may be considered where a member has failed to comply with a determination.

45. As such, there would be no utility in applying the duty of utmost good faith to interactions with AFCA as the contractual arrangements in place under the AFCA Rules have the same practical effect.

Q32 *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)?*

46. AAI's view is that the duty in s 21, as part of Part IV of the Insurance Contracts Act, does continue to serve a significant purpose. The duty of disclosure obligation in s 21 is important to ensure an insured has disclosed matters which an insurer could not know of, and which are relevant to the insurer's decision as to whether or not to offer an insurance policy. The obligation on consumers is tempered by the reasonableness test in s 21, which provides that a person needs to disclose that which a reasonable person in the circumstances could be expected to know to be a matter so relevant.

47. Further, the combined effect of ss 21, 21A and 21B for eligible contracts of insurance (including motor, home and contents) is that if insurers do not ask specific questions that relate to their decision whether to accept the risk in question, they will not be able to rely on the insured's duty of disclosure. This is supplemented by the misrepresentation prohibitions in ss 23 to 27. As a result, there would be minimal practical difference if the UK approach was applied to eligible contracts of insurance. Change would therefore involve disruption within the insurance industry with no ultimate benefit to consumers.

REGULATION

Q33 *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?*

48. As set out in its response to the ASIC Enforcement Taskforce on 26 July 2017, AAI is supportive of all industry participants being required to comply with the Code as the current voluntary nature of the Code means that it may not be clear to consumers whether an insurer is a Code subscriber, making it difficult for consumers to be assured of a standard level of conduct by insurers. Making subscription to the Code compulsory would provide both industry and consumers with assurance that all insurers are committed to certain minimum standards.

Q34 *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))?*

49. AAI believes that the current regime, along with the current proposals in place to strengthen Code compliance and the EDR process, provide effective and sufficient protection for customers. In this regard, AAI notes that:

    (a) the Code sets out a comprehensive dispute resolution and oversight regime, including the independent CGC to address breaches of the Code. FOS (and going forward AFCA) and the CGC are the forums where most breaches of the Code are raised and resolved, through consumer and third-party complaints, insurers' self-reporting, FOS/AFCA reports to the CGC and the CGC's own-motion inquiries;

13 AAI has responded to this question on the basis of its arrangements that are now in place in relation to the Australian Financial Complaints Authority, rather than former arrangements it had in place with the Financial Ombudsman Service (FOS) Australia.

(b) ASIC is able to take the Code (and any breaches thereof) into account, when exercising its existing powers. AFCA will have enhanced obligations to report systemic issues to ASIC, as well as an ability to report other serious breaches including non-compliance with the AFCA Rules.[14] This capacity will be enhanced if, as expected, the Code is submitted to ASIC for approval under RG 183 and is approved; and

(c) if the Code is approved by ASIC, the CGC will be required to provide reports to ASIC regarding breaches of the Code, and to report systemic Code breaches and misconduct (under RG 183). This will enable ASIC to identify and act on concerns regarding breaches of the Code, particularly systemic breaches.

50. AAI does not believe that it would be in the best interest of consumers if a failure to comply with the Code were to constitute a breach of the law because it would ultimately result in the adoption of a less robust code, which does little more than restate the statutory position. A code of that nature would not offer consumers any further protection than currently exists and would undermine the purpose of the Code, which is to set out best practice standards for the industry to comply with legislative requirements. It is designed to complement the law (for example, by providing industry-agreed standards for service delivery that are not prescribed in legislation). Indeed, ASIC has noted that it considers the primary role of a code is to raise standards and to complement the legislative requirements that already set out how entities deal with consumers.[15]

51. As noted above, if a breach of the Code were to constitute a breach of the law, many of the obligations that are currently in the Code would likely be removed from the Code. In this regard, AAI notes that the current review of the Code has proposed the introduction of new obligations that are completely removed from the scope of financial services legislation, such as the proposed provisions discussing vulnerable customers (in particular, the requirement to have a policy on family violence). These provisions of the Code are examples of the general insurance industry determining what it should do in order to meet community expectations, in addition to the requirements of black letter law. Breaches of those provisions, however technical and for whatever reason, should not automatically be a breach of financial services legislation (which may have significant consequences for a licensee) and, as such, they would not be included in the Code if it were to have that impact.

52. Further, breaches of the Code can vary in severity, and are often very minor. For example, contacting a customer a day later than the timeframe specified in the Code – particularly during a declared catastrophic event – would be a breach of the Code despite extenuating circumstances. AAI does not consider that insurers should be exposed to potentially significant penalties for a minor breach of the Code.

53. Against that background, an insurer should not be considered to have contravened legislation for a breach of obligations that the regulator views as being in addition to legal requirements. Such an approach would remove the distinction between 'black-letter' law and more flexible, industry-based regulation that can adapt more quickly to changes in community expectations.

Q35 *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?*

54. The purpose and efficacy of infringement notices is best understood in the context of the broader regulatory framework. AAI's view is that an effective responsive regulatory regime requires regulators to have a range of tools available to respond to different types of conduct in different circumstances.[16] This necessarily requires the regulatory regime to focus on more than just punishment of misconduct. The regulatory regime must strike a balance between oversight, cooperation, and enforcement, and engender openness and transparency between insurers and regulators to facilitate and encourage compliance.

55. Infringement notices are one of the tools available to regulators to deter and punish misconduct. Infringement notices are administrative actions issued for relatively minor contraventions of the consumer protection provisions of the ASIC Act, among others.[17] Infringement notices are typically used for low-level contraventions and offences and where a high volume of uncontested contraventions is likely.[18] They are an important part of ASIC's enforcement toolkit which enable minor contraventions to be dealt with expeditiously. An admission of liability is not required and subsequent action cannot be taken if the entity complies with the infringement notice. The number of penalty units reflects the Parliamentary purpose of infringement notices being to address less serious conduct.

14 See AFCA Rule A.17.5 and A.18.2.

15 See ASIC Regulatory Guide 183 Approval of Financial Services Sector Codes of Conduct at 183.4.

16 A summary of the "enforcement pyramid" proposed by John Braithwaite is extracted at 2.60 of Australian Law Reform Commission Report 95, 2003, as follows: 'My contention is that compliance is most likely when the regulatory agency displays an explicit enforcement pyramid. … Most regulatory action occurs at the base of the pyramid where initially attempts are made to coax compliance by persuasion. The next phase of enforcement escalation is a warning letter; if this fails to secure compliance civil monetary penalties are imposed; if this fails, criminal prosecution ensues; if this fails the plant is shut down or a licence to operate is suspended; if this fails, the licence to do business is revoked. The form of the enforcement pyramid is the subject of the theory, not the content of the particular pyramid.'

17 See ASIC Information Sheet 151. A similar regime exists under s 1313 of the Corporations Act in respect of penalty notices for conduct that ASIC believes constitutes a prescribed offence. Legislation introduced to Parliament on 24 October 2018 by the Treasurer would harmonise the penalty notice regime with the existing infringement notice regime under the ASIC Act and extend the range of provisions that are subject to infringement notices: Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Bill 2018.

18 Australian Law Reform Commission, December 2002, Review of Civil and Administrative Penalties, (ALRC 95), paragraph [4.71], available: **http://www.austlii.edu.au/au/other/lawreform/ALRC/2002/95.html**.

56. The benefits of infringement notices, as distinct from the commencement of civil penalty proceedings or criminal prosecution, include avoiding unnecessary legal costs and greatly reduced time to finalise the matter. They also ensure resources are being directed to remediating customers rather than defending enforcement action or, in the case of regulators, investigating other issues within remit. The issue of an infringement notice can result in conduct of concern ceasing swiftly as well as sending a message to the market at large as to the types of conduct that ASIC considers to be unacceptable. The recipient of an infringement notice is also exposed to reputational damage arising from media releases from regulators when infringement notices are issued. AAI believes that infringement notices afford appropriate attention to the key considerations of punishment, deterrence, and likelihood of recurrence.

57. The current regime allows for flexibility and agility – ASIC has options to take action that is punitive, protective, preservative, corrective or compensatory, and may involve a negotiated resolution. These different types of action carry a different deterrent value, both in terms of specific deterrence of a particular entity or individual, and general deterrence for those within an industry. As set out in ASIC Info Sheet 151, ASIC considers a range of factors when determining which mechanism to use to pursue enforcement action, such as whether there is evidence that the contravention involved dishonesty or was intentional, reckless or negligent, whether the conduct is continuing, whether remedial steps have been taken and the amount of any loss.

58. Under the current regime ASIC has the ability to exercise its enforcement discretion by the use of a number of enforcement tools, depending on the severity of the conduct in question, including infringement notices, corrective advertising, enforceable undertakings and, where the conduct is more serious, to commence proceedings. Where ASIC determines that the most appropriate tool in a particular situation is to issue infringement notices, it has the discretion to issue a number of infringement notices in respect of a course of conduct, which has the effect of increasing the amount payable by an entity for a course of conduct.

59. AAI's view is that the purpose of infringement notices remains valid, and that the current regime is sufficient given the range of tools that ASIC has to enforce its legislation. As to the number of penalty units, AAI notes the Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Bill 2018, which proposes to standardise the financial penalty for infringement notices.

COMPLIANCE AND BREACH REPORTING

Q36 *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?*

60. AAI's view is that there is already a robust and effective regime comprising numerous mechanisms for external oversight of the adequacy of compliance systems, such as:

(a) Annual external audit of AFS licensee compliance regarding financial requirements under the Corporations Act, which includes a review and certification of compliance with AFS licence conditions. In addition to the external audit, the auditor has an obligation to report to ASIC any conduct which may constitute a contravention of licence conditions;

(b) Breach reports lodged by organisations provide ASIC and APRA with a view of the entity's compliance arrangements and often result in regulator oversight of remediation programs associated with the breach. The self-reporting regime is unique to the Australian financial services industry and a large number of contraventions are reported under these obligations, which then fall for consideration by the regulator as part of their overall enforcement initiatives;

(c) Prudential supervision for APRA-regulated entities, including:

(i) Triennial external review under CPS 220 of the adequacy and effectiveness of the entity's risk management framework (**RMF**), with appropriate focus on the compliance function;

(ii) Annual review of the RMF by Internal Audit as per CPS 220;

(iii) Annual declaration on systems being in place and operating effectively to ensure compliance with all prudential requirements; and

(iv) Annual Prudential Review/Assurance Report by the Appointed Auditor on compliance with the relevant prudential legislation (for the particular regulated institution); and

(d) Annual Code certification submitted to the CGC, which includes information on compliance systems of the organisation insofar as they apply to the Code.

61. APRA and ASIC also have oversight of the industry and regularly undertake supervisory action including conducting industry-wide reviews, individual surveillances, prudential site visits, prudential targeted reviews, requests for information, and ad-hoc inquiries or statutory production notices. In recent years, AAI has experienced ASIC adopt a consultative and effective approach on topics such as underinsurance and non-insurance (affordability issues), improved disclosure, and innovation initiatives. While ASIC has also undertaken comprehensive industry-wide reviews, some of these (such as in relation to home building insurance, no-claims discount schemes, and motor vehicle insurance claims handling and dispute resolution) have failed to identify large scale deficiencies and resulted in findings which in AAI's view were not proportionate having regard to the extensive reviews that were performed. AAI considers that better use could be made of smaller test and learn approaches to diagnose the extent of the risk/issue, consistently with the Commonwealth's Regulator Performance Framework.

62. In addition, oversight of licensees is also undertaken by dispute resolution schemes. FOS systemic issues, for example, highlight compliance issues, with reporting required by the financial services provider to the dispute resolution scheme on how the compliance issue will be addressed. As noted above in relation to Question 34, FOS (and soon AFCA) have obligations to report systemic issues to ASIC.

63. The accountability for ensuring the adequacy of compliance systems in financial services entities, and in participating fully and frankly in the existing regulatory regime, ultimately rests with the Board of the entity and this should remain the case.

Q37 *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?*

64. AAI endorses the ICA response to this question.

Q38 *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?*

65. It is incumbent upon an entity to take steps to ensure that it has a culture that supports compliance and it should articulate the kind of culture it aspires to and understand the levers that can influence culture. Entities should also be able to demonstrate how they report on culture to senior management and the Board. If an organisation identifies that it does not have the desired culture, it must influence the levers that will drive a change in culture. Ultimately the culture of an organisation must be led from above; set by management and overseen by the Board. It should value compliance with financial services laws and take account of the expectations of a range of stakeholders including customers, the community, shareholders and regulators. Regulators should provide feedback on industry best practices that they have observed that foster a strong culture and provide feedback to institutions on the culture they are observing through regulatory interactions with that institution.

Q39 *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?*

66. AAI broadly supports the recommendations in the ASIC Enforcement Review Taskforce Report and notes the acceptance by the Australian Government of almost all of the recommendations and the proposed Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Bill 2018 to address some of these recommendations. That Bill was first read in Parliament on 24 October 2018. AAI stresses the importance of industry having an opportunity to comment on draft legislation as recommendations progress toward implementation, so that due consideration can be given to the interaction between the existing statutory obligations and the different proposed legislative elements.