

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

**SUBMISSIONS OF THE AUSTRALIAN SECURITIES AND INVESTMENTS
COMMISSION**

ROUND 6: INSURANCE

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? (Q 1)

1. In ASIC's view, the answer to the first question is no. ASIC has publicly expressed concerns about practices in the life insurance sector, most recently in reports released in August and September of this year.¹
2. As to the second question (that is, what should be changed), the regulatory regime should be improved by reference to the following:
 - a. with respect to insurance specifically:
 - i. generally treating insurance products (including funeral expense insurance policies) as analogous to other financial products under the *Corporations Act 2001* (Cth) (**Corporations Act**);
 - ii. extending the unfair contract terms regime in the *Australian Securities and Investments Commission Act 2001* (Cth) (**ASIC Act**) to insurance products;
 - iii. conferring upon ASIC powers in relation to conduct in the insurance claims handling process;
 - iv. introducing civil penalties for a breach of the duty of utmost good faith in s 13 of the *Insurance Contracts Act 1984* (Cth) (**ICA**);
 - v. considering further reform in relation to the payment of conflicted remuneration to sales of insurance products;

¹ See, eg, Parliamentary Joint Committee on Corporations and Financial Services Inquiry into the life insurance industry submission by ASIC, January 2017; Senate inquiry into the scrutiny of financial advice submission by ASIC, December 2014; Senate inquiry into the life insurance industry (as part of the inquiry into the scrutiny of financial advice) submission by ASIC, April 2016; ASIC Report 587, 'The sale of direct life insurance' (August 2018) (**ASIC Rep 587**); ASIC Report 588, 'Consumers' experience with the sale of direct life insurance' (August 2018) (**ASIC Rep 588**); ASIC Report 591, 'Insurance in Superannuation' (September 2018) (**ASIC Rep 591**).

- vi. considering further use of standardised definitions in insurance policies; and
 - vii. the provision of more public and comparable data about consumer outcomes in the insurance sector eg claims outcomes; and
- b. with respect to all financial products and services, but relevantly which ASIC considers likely to have a significant impact on improving consumer outcomes in insurance:
- i. providing ASIC with product intervention powers, the power to enforce design and distribution obligations, and an enhanced directions power; and
 - ii. considering further reform to the regulation of financial advice.
3. ASIC supports the policy changes identified in paragraphs 2(a)(i)-(iv) and (b)(i) in order to enable it to take action to deal with problems in this sector. Taken together, they should significantly modify the conduct of product issuers and distributors as well as enhance ASIC's ability to take action to prevent consumer harm caused by unfair conduct.
4. An area which ASIC recognises as calling for obvious reform concerns the sale of funeral expenses policies.² ASIC's work, and evidence before the Commission, suggests that funeral expenses policies are especially prone to poor selling practices.³ If funeral expenses policies are to be allowed to be sold, the law should be amended so that such policies fall within the definition of "financial product" in the Corporations Act.
5. Treating funeral expenses policies as "financial products" would attract the application of the licensing and disclosure requirements in the Corporations Act to these policies (including consumer access to a free external dispute resolution scheme), and confer regulatory oversight by ASIC over such policies. This is desirable because funeral expenses policies can create significant consumer harm and, for this reason, should be subject to a similar level of regulation as other insurance or risk management products (including the proposed design and distribution obligations and product intervention power). Further reforms, such as a ban on outbound sales of this product and caps on premiums, should also be considered.

² The problematic aspects of funeral expenses policies were examined in a case study concerning the Aboriginal Community Benefit Fund in the Commissions' Round 4 Hearings: see T4129.34-T4131.3.

³ See ASIC Report 454, 'Funeral insurance: a snapshot' (October 2015) at [26(b)], [27] (**ASIC Rep 454**); ASIC Media Release 99-290; *Australian Securities and Investments Commission v Aboriginal Community Benefit Fund* (2004) 136 FCR 155.

PART A. PRODUCT DESIGN

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

6. ASIC considers that there are certain insurance products that should not be sold. A lack of effective competition and demand-side pressure associated with complex products like insurance means that, in some instances, market forces alone will not drive poor products from the market. Therefore, more significant interventions are needed to prevent consumer harm.
7. In general terms, low-value products have a higher risk of being misunderstood by consumers and of being associated with unfair sales practices. ASIC’s anticipated product intervention power should help address some of these situations over time, including through the use of data to test product outcomes, but ASIC is also of the view that there are some products that can be identified now as requiring more immediate action. Some of these products are discussed in detail below.
8. In ASIC’s view, the following products create significant risk of consumer detriment and should not be sold:
 - a. accidental death insurance⁴ (see ASIC Report 587 (‘The sale of direct life insurance’ (**ASIC REP 587**))), which is particularly objectionable due to the low likelihood of consumers being able to make successful claims arising from the substantial limitations and exclusions that are applied;⁵
 - b. Total & Permanent Disability (**TPD**) insurance cover when the claimant’s entitlement to receive payment under a claim is assessed under activities of daily living (**ADL**) or activities of daily work (**ADW**) tests; and
 - c. insurance covering damage to the tyres and rims of a car. This product covers the cost of repairing or replacing damaged tyres and rims from blowouts, punctures or other road damage. In ASIC Report 492 (‘A market that is failing consumers: The sale of

⁴ For example, the evidence given by Mr Martin on behalf of ClearView demonstrated that the number of claims made under ClearView’s accidental death cover was very small, and that only a very small amount was paid out to consumers in comparison to the premiums that would be paid (including a ratio of claims paid out to premiums collected being 1% in a particular year): T5321.43-T5322.36. Further, the Freedom case study demonstrated (as Freedom accepts in its Round 6 submissions at [12]) that the practice of selling accidental death policies creates a risk that a consumer thinks they are getting something like a life policy for less. Moreover, the case study concerning inappropriate selling by Freedom to Mr Stewart’s son concerned a policy that had a component for accidental death or accidental injury, with the premium for that part of the insurance cover payable 12 days after the inappropriate sale to Mr Stewart’s son.

⁵ ASIC Rep 587 at pp 68-69.

add on insurance through car dealers’ (**ASIC REP 492**)), ASIC found that the average claim was \$334, suggesting that consumers would generally be better off self-insuring.⁶

9. Disclosure obligations are unlikely to solve the problems associated with the sale of these products: see response to Question 4 below.

Accidental death insurance

10. In relation to accidental death insurance, ASIC’s review of data shows that this product offers dubious benefits to consumers, with a claims ratio for the 2015-2017 financial years of 16.1% (meaning that, for every \$1 of premium paid by consumers, a mere 16 cents was paid out in claims by insurers).⁷ Claim outcomes are also extremely poor, with accidental death insurance having a very low admitted claims rate (of 26%) compared to other direct life insurance products (TPD – 44%; income protection – 54%; trauma – 68%; term life – 75%).⁸
11. ASIC considers these poor outcomes are largely due to the design of accidental death insurance products, including the significant limitations of the cover. The definition of ‘accident’ in an accidental death insurance policy generally refers to external physical forces being ‘independently’ or ‘solely’ the cause of death, meaning that if a person dies as a result of multiple factors, even if it is partly due to an accident, a claim may be declined.⁹ Accidents make up a very small proportion of deaths in Australia (around 5% in 2016, according to statistics published by the ABS) and a further proportion of these deaths would not be covered by accidental death insurance due to common exclusions, such as the consumption of drugs or alcohol, and certain occupations, pastimes and sports.¹⁰
12. ASIC is also particularly concerned about the common practices of accidental death insurance being sold in the following circumstances:
 - a. as an additional benefit to a term life insurance policy, which does not appear to meet any consumer need as the term life policy would provide cover for death due to accidents as well as illness and disease;¹¹ or

⁶ ASIC Report 492, ‘A market that is failing consumers: The sale of add on insurance through car dealers’ (September 2016) at p 17 (**ASIC Rep 492**).

⁷ ASIC Rep 587 at p 70.

⁸ ASIC Rep 587 at p 32.

⁹ ASIC Rep 587 at p 69.

¹⁰ ASIC Rep 587 at p 69.

¹¹ ASIC Rep 587 at p 69.

- b. as a ‘downgrade’ when a consumer seeking comprehensive term life insurance is declined due to eligibility or underwriting criteria, when again the policy may not meet the consumer’s needs if they are seeking comprehensive cover.¹²
13. Accordingly, accidental death insurance products should not be sold unless there is evidence to demonstrate that the products offer value to consumers and satisfy a genuine consumer need. This reflects ASIC’s broader view that insurance products that offer little or negligible benefit to consumers should not be sold,¹³ and that any products sold to consumers should be able to be demonstrated to offer value to at least a segment of consumers.

Total and permanent disability insurance – ADL and ADW tests

14. ASIC has commenced an analysis of consumer outcomes in relation to TPD policies where the consumer’s entitlement is assessed under an ADL or ADW test.
15. TPD cover in superannuation is triggered when the fund member meets the definition of “total and permanent disability” specified in the relevant policy of insurance. Most people who make a claim are assessed under “any occupation” tests. “Any occupation” tests seek to assess claims by asking whether the claimant is unlikely to work again in any occupation for which they are suited by education, training or experience. However, a minority of people may only be eligible to make claims under a more stringent ADL or ADW test, which typically requires the claimant to show that they are unable to undertake a number of basic living activities such as showering/bathing and going to the toilet. This minority of claimants often includes people who are working casual or part time and, for this reason, are often automatically defaulted to the ADL or ADW test.
16. ASIC’s initial findings show that:
- a. around 3% of claims made during the 2016 and 2017 calendar years were assessed under either the ADL or ADW test – approximately 890 claims; and
 - b. the average declined rate of claims assessed under ADL/ADW was more than 50%, with some of these products held within superannuation having a much higher decline rate.
17. ASIC’s review of TPD insurance claims is ongoing.¹⁴

Tyre and rim insurance

¹² ASIC Rep 587 at pp 49-50.

¹³ This extends beyond life insurance products and would include, for example, tyre and rim insurance which offers no or negligible benefits to consumers except in respect of luxury cars.

¹⁴ See ASIC Rep 591.

18. It is evident that tyre and rim insurance is a poorly designed negative or low-value product. In ASIC REP 492, ASIC found that the commissions paid to dealers for tyre and rim insurance during the 2013-2015 financial years were 5.5 times more than the total claims paid to policyholders. The product has a very low claims ratio.¹⁵ In 2013-2015, the average claim payout for tyre and rim insurance was only 80% of the average premium paid. (In addition, consumers usually also pay interest on the premium paid under the related vehicle finance contract.) This means that even if a consumer made a claim, in most cases they would not claim back as much as they paid for the policy. In ASIC's opinion, tyre and rim insurance should not be offered other than for luxury vehicles.
19. The proposed design and distribution obligations will likely limit the sale of the products mentioned above, as product issuers will need to ensure that they are designing and distributing products to consumers for whom the product would be suitable.¹⁶ Based on our reviews, we consider that the products are unlikely to be consistent with the needs and objectives of consumers in most cases. ASIC's proposed product intervention powers will complement the design and distribution obligations. As currently drafted the Bill would empower ASIC to make orders about specific conduct in relation to financial products where ASIC is satisfied that the product will result in significant detriment to consumers. This will enable ASIC to provide a flexible and graduated response to low-value products, including banning them (noting that the Bill requires ASIC to conduct consultation before making any final decision to ban a product).

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

20. ASIC supports the Life Insurance Code of Practice requirements to update medical definitions regularly so that products *are not sold* with out of date definitions. However, law reform would be required in order to require updated medical definitions to be extended to products other than on-sale products. As noted in ASIC Report 498 ('Life insurance claims: an industry review' (ASIC REP 498)), life insurance products are sold as guaranteed renewable products, so that the life insurer must continue to maintain the life insurance product so long as the policyholder pays the premiums.¹⁷ The law prohibits life insurers from changing the terms and definitions of a guaranteed renewable life insurance policy without the consent of the policyholder, which is an important protection for policyholders.¹⁸ This

¹⁵ ASIC Rep 492.

¹⁶ See *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Power) Bill 2018*.

¹⁷ ASIC Report 498, 'Life insurance claims: an industry review' at [11] (ASIC Rep 498).

¹⁸ ASIC Rep 498 at [11].

does, however, contribute to a structural issue within the life insurance industry and explains why policyholders may find themselves with policies that contain out of-date medical definitions.¹⁹ That may work out favourably or unfavourably for different cohorts of policyholders (depending, for example, on whether or not changes in medical practices result in an expanded or narrowed definition of a relevant condition).²⁰

PART B. DISCLOSURE

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:

- **the purpose(s) that the product disclosure regime should serve;**
- **whether the current regime meets that purpose or those purposes; and**
- **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.) (Q 4)

21. In ASIC's view, the current disclosure regime for financial products does not adequately serve the interests of consumers.
22. The key problem with the current regime is that there is an *over-reliance on disclosure* as the mechanism to address a wide range of product and conduct problems. The assumption underlying the current regulatory regime is that disclosure will, in effect, remedy competition failures, misaligned incentives, poorly designed products etc. In short, while disclosure is important, too much weight is put on disclosure to fix problems that it cannot fix. For example, there is now clear evidence that disclosure is a poor tool to address harms arising from conflicts of interest in remuneration.
23. More recent reforms have, in some areas, begun to reduce this over-reliance on disclosure (eg prohibitions on certain conflicted remuneration under FOFA). However, there are still many instances where disclosure is expected to ensure good market outcomes without adequate consideration of whether it is the right regulatory tool in the first place.
24. Further, disclosure is also expected to overcome limitations in consumer understanding and consumer behavioural biases. The disclosure regime assumes that consumers use information

¹⁹ ASIC Rep 498 at [12].

²⁰ ASIC Rep 498 at [12].

optimally in a narrow instrumental sense, that they are not prone to decision biases, that they have the ability to undertake complex calculations etc. The regime assumes that demand-side drivers of competition are effectively at work in financial services. This is at odds with how people behave in many decision-making contexts in financial markets.

25. A secondary problem is that, under the current regime, much disclosure is poorly designed, overly complex, and poorly targeted. That is, even where disclosure is an appropriate or necessary device, it is not designed in a way to facilitate good consumer decision making or better market outcomes. An example is the cost of a financial product or service – this is information that any consumer will need but too often is described or explained in an overly complex manner.
26. A third factor which affects the efficacy of disclosure for insurance products is that they are covered by disclosure obligations in both the Corporations Act and the Insurance Contracts Act which have overlapping obligations, and sometimes inconsistent obligations.²¹
27. While disclosure is a necessary component of the regulatory regime, it is not sufficient (on its own) to ensure good consumer outcomes. It will usually work best alongside other regulatory tools, and in some instances other regulatory tools are better for addressing market problems.
28. Disclosure, if well designed, should:
 - a. contribute to market transparency and efficiency;
 - b. provide information that is valuable to the private sector and to regulators, including ASIC;
 - c. facilitate innovative development of private sector applications or tools; and
 - d. act as post-purchase reference documents for consumers in the event of a dispute.
29. Some of the limitations of disclosure include:
 - a. disclosure is generalised: it is not designed to maximise a consumer's understanding of the product as it applies to them individually and fails to account for the fact that any one piece of information is used and understood differently from person to person and situation to situation;
 - b. the regime is process-based and designed to fulfil contractual and legislative obligations to disclose the terms of the product, not to optimise consumer understanding of products;

²¹ For instance in relation to the ability to use digital communications.

- c. disclosure typically occurs at a time when it is unlikely to be relevant to consumer decision making (e.g. after the consumer has already made the decision to purchase the product)²² and all forms of disclosure compete with more compelling and timely influences (such as sales staff, advertising and friends and family);
 - d. financial products are inherently complex (particularly where the consumer needs to assess risk, probability and the uncertain future performance of the product on the basis of limited information and with innately constrained cognitive capacity) and strategic product complexity and sales techniques can defeat consumer attempts at understanding even simplified disclosures (e.g. bundled products and pricing, confusing and opaque ‘discounts’, unclear fee descriptors); and
 - e. the disclosure regime does not allow for effective product comparison as it is only designed to inform consumers about the product being sold, rather than enabling them to compare and choose between similar products.
30. Further, disclosure documents do not generally enhance consumer decision-making or assist consumers to make real-time comparison of products and services to their benefit. The detail and complexity associated with full disclosure may, in some cases, deter consumers from engaging meaningfully or at all with what is being disclosed. This difficulty is unlikely to be assisted by shorter and/or simplified forms of disclosure, which have also been shown to fail to enhance consumer decisions and outcomes.²³
31. Disclosure can be worse than merely ineffective. A significant problem with the current disclosure regime is that, in the absence of complementary supply-side regulation, the regime imposes the burden on consumers to protect themselves from the harm that may be caused by firms that either adopt an “anything goes, as long as you disclose” approach²⁴ or that seek to hide behind mandatory, technical disclosure requirements despite clear evidence that consumers are using products in ways that are not in their best interests (e.g. paying for services they do not receive). The burden that is placed on consumers is inconsistent with recognised research and knowledge about consumer behaviour, and permits market conduct that is inconsistent with community expectations.

²² These limitations are more pronounced when the product is sold under a general advice model, when the salesperson can promote the benefits of the product irrespective of whether it meets the consumer’s needs.

²³ Justin Malbon and Harmen Oppewal, ‘(In)effective disclosure’ (September 2018), <https://australiancentre.com.au/publication/ineffectivedisclosure/>; Bateman, H et al (2013), ‘As Easy as Pie: How retirement savers use prescribed investment disclosure’, <https://pdfs.semanticscholar.org/6f47/f1345d6724db62419d6d341e3c70d678bfdb.pdf>.

²⁴ Peter Kell, Deputy Chairman, ASIC speech ‘ASIC and behavioural economics for real people’ (October 2016), <https://download.asic.gov.au/media/4051518/peter-kell-speech-qube-symposium-published-21-october-2016.pdf>.

32. A fundamental problem is that consumers will not generally test or challenge disclosures made to them by insurance and financial services providers.²⁵ Rather, consumers enter into relationships with financial firms with a degree of trust or belief. This is consistent with empirical evidence that disclosure, in all of its forms (whether detailed or summary in nature), does not adequately limit consumer harm or provide consumer benefits in the way that it is intended. As an example, research suggests that:
- a. most consumers do not read properly or at all large amounts of disclosure documents;
 - b. consumers overestimate their level of understanding of information disclosed; and
 - c. even simplified, tested, ‘dashboards’ are prone to misuse (by consumers) and manipulation (by firms).²⁶
33. Recent research by Monash University²⁷ examining the effectiveness of home contents PDSs and key facts sheets in assisting consumers to select the best policy that suits their needs found that: “despite ideal and simplified conditions, up to 42% of participants chose the worst offer, despite being given the time and opportunity to review the disclosure information. When able to choose from three policies, 35% chose the worse policy and only 46% found and selected the best policy. There was no simple and consistent effect of disclosure – while participants were more likely to forego purchasing an insurance policy when they had only access to the PDS the results did not find a clear pattern of understanding where people were provided more or less disclosure information. Purchasing decisions were not affected by the way in which the consumer viewed the disclosure (i.e. computer or smart phone).”
34. The significance of these problems has emerged in the evidence presented to this Royal Commission concerning the mis-selling of life insurance, funeral insurance and add-on insurance products. That evidence is consistent with ASIC’s findings that:²⁸
- a. disclosure has not been a brake or constraint on the sale of unsuitable insurance products (including products that consumers are not eligible to claim under);

²⁵ See ASIC Report 415, ‘Review of the sale of home insurance’ (October 2014) (**ASIC Rep 415**); ASIC Report 416, ‘Insuring your home: Consumers’ experiences buying home insurance’ (October 2014).

²⁶ Bateman, H et al (2013), ‘As Easy as Pie: How retirement savers use prescribed investment disclosure’, <https://pdfs.semanticscholar.org/6f47/f1345d6724db62419d6d341e3c70d678bdfdb.pdf>.

²⁷ Justin Malbon and Harmen Oppewal, ‘(In)effective disclosure’ (September 2018) <https://australiancentre.com.au/publication/ineffectivedisclosure/>.

²⁸ ASIC Rep 587; ASIC Rep 588; ASIC Rep 492; ASIC Report 470, ‘Buying add-on insurance in car yards: Why it can be hard to say no’ (February 2016) (**ASIC Rep 470**); ASIC Report 256, ‘Consumer credit insurance: A review of sales practices by authorised deposit-taking institutions’ (October 2011).

- b. disclosure has not prevented unfair sales where consumers have been unaware that they have purchased insurance products, the price of those products and/or the risks covered by the product; and
 - c. some consumers have poor or no recall of receiving disclosure documents prior to purchasing insurance products.
35. Accordingly, firms with misaligned incentives have both the opportunity and commercial incentive to use the detailed information they hold about consumers, the direct access they have to consumers, and their marketing expertise to render the disclosure regime ineffective.
36. ASIC considers that the Government's reform agenda provides an opportunity to continue the move away from an over-reliance on disclosure. The proposed introduction of the design and distribution obligations will provide increased accountability for issuers and distributors across the product life cycle, thereby shifting some responsibility for product suitability decisions from consumers to industry. Taken together with the proposed product intervention power, these reforms will facilitate ASIC taking a broader regulatory approach beyond disclosure-based interventions to improve consumers outcomes. In order to maximise the opportunity afforded by these new powers, ASIC considers it important that they be prioritised in the Government's reform agenda and the design and distribution obligations extended to cover all insurance products under ASIC's remit. These reforms should be supplemented by a strengthening of ASIC's enforcement powers, including improving ASIC's ability to ban improper, unfit or incompetent individuals, and strengthening ASIC's ability to refuse, revoke or cancel financial services licences where the licensee is not fit or proper.

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? (Q 5)

37. In ASIC's view, the standard cover regime in Division 1 of Part V of the ICA – which intends to set out the minimum requirements for a general insurance policy to provide “standard cover” – is not achieving its purpose because it is not utilised by insurers. In ASIC's view, insurers deliberately circumvent the application of standard cover by utilising the opportunity provided by s 35(2) of the ICA.²⁹
38. The standard cover regime in Part V of the ICA may be avoided if the requirements of s 35(2) of the ICA are met. Under s 35(2), an insurance contract can provide less than standard cover if:

²⁹ See, eg: The Senate, Economics References Committee, 'Australia's general insurance industry: sapping consumers of the will to compare', August 2017 (**Senate Inquiry General Insurance Report**) at 3.51-3.56.

- a. the insurer clearly informed the insured in writing (whether by providing the insured with a document containing the provisions, or the relevant provisions, or the proposed contract or otherwise); or
 - b. the insured knew, or a reasonable person in the circumstances could be expected to have known, that the insurance contract provided less than the standard cover, or no cover.
39. Unfortunately, this mechanism provides a convenient means by which insurers can circumvent the standard cover for which Part V of the ICA provides because insurers can meet the requirement to “clearly inform” consumers in writing by simply providing consumers with a PDS. Additionally, s 69 of the ICA allows provision of required written information to be given within 14 days **after** the contract is entered into. Section 69(1) applies where it is not reasonably practicable to give the information in writing, but it is reasonably practicable for it be given orally; and s 69(2) applies where it is not reasonably practicable to give the information orally or in writing. There may be considerable uncertainty about whether it would be reasonably practicable to give orally information about terms that are less than standard cover. These concessions are relevant to telephone sales of insurance contracts.³⁰
40. The ease with which insurers are able to avoid the provision of standard cover in accordance with Part V of the ICA was raised before the Senate Inquiry into General Insurance.³¹ The shortcomings of PDS disclosure in providing real benefits in terms of consumer knowledge and understanding of the terms of insurance products are discussed above in response to Q 4.
41. An alternative may be to mandate that insurers cannot derogate from the standard cover regime in Part V of the ICA. ASIC understands that the operation of the standard cover regime is an issue that the Government is considering following the Senate Inquiry’s recommendation that the Government “initiate an independent review of the current standard cover regime with particular regard to the efficacy of current disclosure requirements.”³²
42. If standard cover was adopted as a minimum standard, it should also be extended to other insurance products, for example, gap insurance.

³⁰ See commentary on purpose of s 69 in pp 100 - 101 of the Explanatory Memorandum to the Insurance Contracts Bill 1984, http://classic.austlii.edu.au/au/legis/cth/bill_em/icb1984230/memo_0.html; and paragraphs 44 - 45 of the Australian Law Reform Commission, Report No 20: Insurance Contracts (December 1982), <http://www.austlii.edu.au/cgi-bin/sinodisp/au/other/lawreform/ALRC/1982/20.html?stem=0&synonyms=0&query=law%20reform%20insurance%20contracts>.

³¹ Senate Inquiry General Insurance Report at 3.51-3.56.

³² Senate Inquiry General Insurance Report, Recommendation 5.

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

General insurance

43. The Report of the Senate Inquiry into General Insurance noted that the inconsistent use of definitions across insurance policies is a barrier to product comparability, and that inconsistent definitions risk misleading consumers into believing they have cover for certain events when they do not.³³ The Inquiry Report identified the standardisation of key policy terms as a way of addressing these issues.³⁴ ASIC agrees that an enhanced use of standardised definitions of key terms in insurance contracts is likely to improve consumer outcomes by minimising the likelihood of consumer confusion, increasing the likelihood of harmonised minimum insurance coverage and by facilitating greater comparability between insurance policies.
44. ASIC has generally supported the use of standardised definitions in insurance contracts, particularly for natural disaster risk. An early report, ASIC Report 7 ('Consumer understanding of flood insurance' (**ASIC REP 7**)), identified that the lack of standardisation of the term "flood" in home and contents insurance documents meant that consumers may not be aware whether they are covered for flood and, if they are, about the importance of the distinction between flood and other storm damage. Accordingly, ASIC REP 7 recommended that insurers simplify and harmonise the drafting of insurance policies so that the availability or exclusion of flood insurance under house and contents insurance policies was clarified, including by:
- a. using key common terms;
 - b. making the distinction between flood, storm and rainwater clear and consistent;
 - c. making the concept of proximate damage clear; and
 - d. identifying the distinction between "all in cover" and "defined event" policies.
45. The confusion described in ASIC REP 7 was subsequently illustrated by issues that arose following the Queensland floods in 2010-2011. Differences in the definition of "flood" caused confusion and perceptions of unequal treatment among policyholders which warranted Government intervention. This intervention resulted in the introduction of a standard definition of "flood" in the *Insurance Contract Regulations*. ASIC's work suggests

³³ Senate Inquiry General Insurance Report at 3.57-3.65.

³⁴ Senate Inquiry General Insurance Report at 3.57-3.65.

that the introduction of a standardised definition of “flood” has enhanced consumer understanding of insurance coverage.³⁵

46. There is an opportunity to consider greater use of standardised definitions in general insurance contracts following the Senate Inquiry’s recommendation that the Government “work closely with industry and consumer groups to develop and implement standardised definitions of key terms for general insurance.”³⁶

Life insurance

47. ASIC supports the use of standard definitions by life insurers. The industry has made progress towards this by including certain standard definitions of common medical conditions in the Life Insurance Code which, in ASIC’s view, will help consumers to understand what is covered by their contracts of insurance, and to enable greater comparability between insurance products (see eg, ASIC’s response to Question 3, which has some application to this question).
48. The Parliamentary Joint Committee on Corporations and Financial Services review of the Life Insurance Industry recommended that:
- a. the life insurance industry regularly update all definitions in policies to align with current medical knowledge and research;
 - b. the industry standardise definitions across all types of policies and use clear and simple language in definitions;³⁷ and
 - c. the Life Insurance Code and the Insurance in Superannuation *Working Group's Insurance in Superannuation Code of Practice* be updated to reflect the above recommendations.³⁸

PART C. SALES

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? (Q 7)

49. Before discussing the specific questions relating to conflicted remuneration and general insurance, ASIC would make the following *general* points about conflicts in remuneration:

³⁵ ASIC Rep 415.

³⁶ Senate Inquiry General Insurance Report, Recommendation 6.

³⁷ Report of the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into the life insurance industry at p xii (**Parliamentary Joint Committee Report**).

³⁸ Parliamentary Joint Committee Report at p xxii.

- a. Conflicted remuneration leads to consumer harms across a wide range of retail financial services;
 - b. ASIC's view is that conflicts in remuneration in financial services should be prohibited or removed as a general policy. (In some cases, transitional arrangements will need to be considered in the implementation of such a change); and
 - c. If there are evidence-based arguments that indicate that the removal of conflicted remuneration would generate costs associated with competition and/or consumer access that clearly outweigh the benefits of reduced consumer harms, then these particular cases could warrant limited exceptions to this rule. This should require ongoing public monitoring and gathering of data on the impacts of conflicts to test whether any exemption should be retained.
50. The ban on conflicted remuneration should be extended to general insurance products. ASIC's view is that the negotiation, payment and acceptance of conflicted remuneration has contributed to poor consumer outcomes, such as sales of products with little or no value to consumers, or which do not meet consumer needs.
51. Conflicted remuneration has resulted in poor consumer outcomes through:
- a. 'reverse competition' as illustrated by the add-on insurance market where insurers were competing for access to car dealer networks to sell their products, which led to dealers demanding higher payments or commissions, driving up the cost to consumers and eroding the value offered by their products;
 - b. 'first mover' problems, where a single entity cannot move to fairer remuneration practices because they will lose business to their competitors; and
 - c. driving sales of low-value products, especially under general advice models.
52. ASIC considers that a ban on conflicted remuneration could encourage insurers to achieve sales through better engagement with consumers, leading to the development of improved sales methods as they would not be able to rely on the payment of commissions to intermediaries. In practice this could mean products being designed and promoted on the basis of cover and price that better meets the needs of consumers.
53. There is a risk that a ban on conflicted remuneration could result in:
- a. a drop in the level of sales of some products; and
 - b. a reduction in competition, if insurers who are largely dependent on intermediaries exit the market.

54. ASIC's view is that these effects are likely to be short-term as insurers would need to innovate and develop new business models.

Should monetary benefits given in relation to life risk insurance products remain exempt from the ban on conflicted remuneration in Division 4 of Part 7.7A of the Corporations Act 2001 (Cth)? Why shouldn't the cap on such benefits continue to reduce to zero? (Q 8)

55. When the Future of Financial Advice (FOFA) reforms were being developed, ASIC's preferred position was that the ban on conflicted remuneration should apply to all benefits given in relation to life risk insurance products. In 2011, ASIC informed the Treasury of this position.
56. Parliament subsequently enacted as part of the FOFA reforms an exemption from the ban on conflicted remuneration for all monetary benefits relating to life risk insurance products.
57. In October 2014, ASIC published Report 413 ('Review of retail insurance advice' (**ASIC REP 413**)) about the quality of advice provided to consumers in relation to life insurance. In ASIC REP 413, ASIC found non-compliant advice in 37% of sampled files and identified a correlation between non-compliant advice, high lapse rates and upfront commission models (compared to hybrid, level or no commission models). A driver of high lapse rates was incentives for advisers to write new business or rewrite existing business to increase commission income. The way an adviser was paid (e.g. under an upfront commission model compared to a hybrid, level or no commission model) had a statistically significant bearing on the likelihood of a client receiving advice that did not comply with the law.
58. ASIC found that the impact of adviser conflicts of interest on the quality of life insurance advice, and policy lapse rates, was an industry-wide problem. ASIC REP 413 made a number of recommendations, including that insurers change their remuneration arrangements, while advisers should review their business models to address structural barriers to the provision of compliant life insurance advice. The findings in ASIC REP 413 were supplemented by a report, Review of Retail Life Insurance Advice published by John Trowbridge, in March 2015 (**Trowbridge Report**), which reported that problems existed in the remuneration structures for advisers and proposed a new "reform model" for adviser remuneration, consisting of a 20% level commission structure.
59. Following ASIC REP 413, the Financial System Inquiry (FSI) and the Trowbridge Report, the Government, in consultation with industry, introduced a package of amendments to limit the payment of commissions and a ban on volume payments for life insurance by. Since 1 January 2018, there has been:

- a. a reduction in upfront commissions — starting with a maximum upfront commission of 80% of the first year premium to apply from 1 January 2018, decreasing to a maximum upfront commission of 60% of the first year premium to apply from 1 January 2020. Ongoing commission would be set at 20% from 1 January 2018;
 - b. clawback over two years to apply from 1 January 2018 as follows:
 - i. if a policy lapses or the premium decreases in the first year of the policy, the amount of commission to be repaid is calculated with reference to 100% of the commission on the first year's premium; and
 - ii. if a policy lapses or the premium decreases in the second year of the policy, the amount of commission to be repaid is calculated with reference to 60% of the commission on the first year's premium; and
 - c. a ban on other forms of conflicted remuneration, consistent with the FOFA reforms, to apply from 1 January 2018.
60. These measures were introduced as a response to the risk, identified in the Trowbridge Report and the Financial System Inquiry, that an abrupt move to ban commissions would result in the cost of advice being passed to consumers, which could result in individuals:
- a. not purchasing life insurance (leading to potential under-insurance); or
 - b. purchasing through alternative channels, which have fewer consumer protections.
61. Since ASIC REP 413, poor quality advice on life insurance has continued. The limitations on life insurance commission have, however, only been in effect since 1 January 2018.³⁹ ASIC will conduct a post-implementation review in 2021 to assess the impact of the reforms. Collection of data to inform this review has commenced.⁴⁰ ASIC considers that if no significant improvement has been made on the findings reported in ASIC REP 413, there would be a compelling case to remove the exemption from the ban on conflicted remuneration currently afforded to the sale of life insurance products altogether.
62. As a preliminary observation and noting that ASIC's review is due only in 2021, in ASIC REP 587 ASIC observed a link between incentive schemes and conduct at point of sale. With one exception, those firms with the incentive schemes that had the most significant conflicts of interest were also the firms who engaged in pressure selling and other practices where a

³⁹ See, eg ASIC Consultation Paper 245, 'Retail life insurance advice reforms' (December 2015).

⁴⁰ ASIC 17-168MR, 'ASIC releases instrument setting the commission caps and clawback amounts as part of the life insurance advice reforms' (5 June 2017).

sale was prioritised ahead of the needs of the consumer. Findings of this kind suggest that the ban on conflicted remuneration should be applied to life insurance products.

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? (Q 9)

63. ASIC considers that banning conflicted remuneration will have a major impact on reducing the likelihood of inappropriate sales tactics. This is likely to be the most important measure to address consumer harms. However, such a change could be complemented by other changes to ensure good consumer outcomes.
64. When considering a ban on conflicted remuneration, documented and informal remuneration, and reward and incentives practices should also be taken into account, as these can also affect the conduct of intermediaries, consumer outcomes and the level of professionalism when giving advice.
65. The risks of mis-selling can also be addressed by robust supervision practices. Sales representatives are more likely to engage in mis-selling:
 - a. if misconduct is unlikely to be identified; or
 - b. when misconduct is identified, it is unlikely to be punished, or any punishment is insignificant or insufficient relative to the financial benefits earned to act as a deterrent.⁴¹
66. Licensees could improve their capacity to identify misconduct by:
 - a. reviewing their distribution channels to identify the specific features that create risks of mis-selling; and
 - b. better addressing the identified risks by improving their current business monitoring and controls (eg through data on trends or patterns in sales activity that could indicate an increased risk of mis-selling).
67. Sanctions should be designed, tested and exercised to ensure they are effective in deterring misconduct. In practice this means that:
 - a. the sanctions on sales persons and intermediaries should include a range of options including financial penalties, and suspension of the ability to sell products or dismissal;

⁴¹ In ASIC Report 471, 'The sale of life insurance through car dealers: Taking consumers for a ride' (February 2016) (ASIC Rep 471), at [117], ASIC found that life insurers had approximately 5,900 authorised representatives who sold add-on insurance products. Only nine authorised representatives had been warned in writing for misconduct, and not a single person had had their authorisations cancelled for misconduct.

- b. those sanctions should be regularly exercised when misconduct is identified, and in a way that is visible to other employees or intermediaries.
68. There should also be consequences for the licensee itself (not just the sales person). There should be broad reviews of past transactions as a sales person or intermediary who engages in misconduct:
- a. is likely to have demonstrated a propensity or appetite to ignore both the firm's business rules and the consumer's interests; and
 - b. is unlikely to act on the singular circumstances of the individual consumer or particular transaction (and may, for example, be motivated by commission or remuneration incentives).
69. Good supervision practices would therefore require a licensee, when an instance of individual misconduct is identified, to review other transactions in which that sales person or intermediary was involved, and develop an effective remediation action plan for all consumers adversely affected by the conduct of that person.
70. There will be circumstances where it is appropriate to inform consumers of the conduct of the intermediary, for example, where the licensee cannot determine whether there has been mis-selling from the documents alone (for example, where the misconduct is based on the conversations at the point of sale).
71. ASIC REP 587 identified a direct link between poor sales conduct and poor consumer outcomes, with ASIC's assessment disclosing that poor sales conduct likely contributed to at least 35% of declined claims and 63% of lapsed policies. This is because poor sales conduct likely led to consumers buying a product:⁴²
- a. they did not want or could not afford, resulting in a lapsed policy; or
 - b. that did not perform as they expected or did not meet their needs, resulting in a declined claim or lapsed policy.
72. The poor sales conduct identified in ASIC REP 587 included pressure selling or other inappropriate sales conduct; upselling and cross-selling; and selecting the cover type or sum insured for the consumer.⁴³ Conflicted remuneration is one cause of the use of pressure selling techniques and other inappropriate sales conduct but there are other reasons why sales representatives use inappropriate sales tactics. As identified in ASIC REP 587, the following practices also play a role in driving inappropriate sales conduct: scripts and training that

⁴² ASIC Rep 587 at [176].

⁴³ ASIC Rep 587 at [420].

encourage concerning sales practices, inadequacies in quality assurance and monitoring of sales conduct, and the inadequacy of sanctions when inappropriate or unfair sales tactics are used. For this reason, we consider that ASIC’s anticipated product intervention powers will help ASIC to regulate the broad range of conduct that contributes to poor consumer outcomes.

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? (Q 10)

73. ASIC REP 587 identified that the direct sale of life insurance by means of outbound telephone calls was linked to inappropriate sales conduct and poor outcomes for consumers, and was likely to reduce informed decision-making. Consistently with the conclusions reached in ASIC REP 587, ASIC supports a ban on the direct sale of insurance via outbound telephone calls. Indeed, as stated in ASIC REP 587, ASIC intends to restrict outbound sales calls for life and funeral insurance and is currently considering the regulatory tools it may use to implement this reform.⁴⁴
74. A ban on the direct sale of insurance via outbound calls is necessary because, in ASIC’s view, the current regulatory regime governing the direct sale of insurance through outbound telephone calls is inadequate to avoid consumer detriment. For example, ASIC notes that the anti-hawking prohibition in s 992A of the Corporations Act does not operate as a general prohibition against outbound and unsolicited sales calls, but only against offering a financial product in an unsolicited call when certain requirements (both before and during the call) are not met. The technical nature of the anti-hawking prohibition means that conduct will be exempt from the prohibition if the offeror complies with the technical requirements stipulated in the Corporations Act. Yet, even where there is compliance with these technical requirements, the risk of mis-selling and inappropriate consumer outcomes remains.
75. The shortcomings of the disclosure regime, as set out in response to Question 4, illustrate how the requirements of s 992A are unlikely to vitiate the detrimental effects of sales call processes.

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,

⁴⁴ ASIC Rep 587 at [78].

what additional changes are required? Are there some financial products that should only be sold with personal advice? (Q 11)

76. Recommendation 10.2 in the Productivity Commission’s report on ‘Competition in the Australian Financial System’ (June 2018) proposes the re-naming of general advice in order to address problems that may arise under the general advice model by reason of the fact that the financial advice framework currently provides fewer protections where a product is acquired via general advice, compared with personal advice.
77. ASIC considers that renaming general advice and only permitting the term “advice” to be used in conjunction with the concept of “personal advice” is a potentially useful step in improving consumer understanding of the nature of the advice that they receive. However, the distinction between “personal” and “general” advice is subtle, and it is unlikely that renaming alone will be sufficient to ameliorate the confusion that consumers may currently experience. Broader options for reform should be considered.
78. In ASIC’s view, any potential reform concerning the labelling and clarifying of “general advice” should consider:
- a. the broad scope of the conduct currently regulated as general advice (and whether a single new name for general advice will assist in improving consumer understanding of all conduct currently regulated as general advice);
 - b. the need to assist product issuers to provide useful targeted information to consumers to help them make decisions about the suitability of key financial products such as home building insurance or their ability to claim under insurance products with eligibility conditions without providing personal advice;
 - c. pressures in the broader regulation of advice (including the need to raise the quality of advice, whether ‘general’ or ‘personal’, and to increase access to financial advice);
 - d. the fact that the current regime (with its focus on advice about financial products) does not readily accommodate many of the types of financial advice consumers seek to access, for example strategic advice/non-product advice, budgeting advice, and aged care advice; and
 - e. consumer behaviour, including that consumers do not interpret or experience advice in the way intended by the regulatory system; consumers’ understanding of what constitutes ‘advice’ is highly contextual and can vary from person to person and situation to situation; this applies to both general and personal advice).

79. Importantly, a key difference between general and personal advice relates to the records that must be kept of the advice and the customer interaction. These are much reduced for general advice, which makes subsequent action either by consumers (eg regarding individual complaints) or regulators more difficult. One measure may be to introduce some additional record keeping requirements for general advice, at least in certain circumstances or for certain products.
80. To this end, ASIC considers that there may be merit in adopting a graduated definition of general advice, and applying a graduated level of regulation depending on the type of advice being given and the importance of that advice to consumers. For example, some types of personal advice (e.g. strategic financial planning or budgeting advice, or advice about certain less complex products such as home building insurance) could be the subject of lighter regulation whereas general advice about a particular product, such as superannuation, should be more heavily regulated. This may take the form of incorporating some of the consumer protections arising under the personal advice model to general advice, or including new, specific, tailored consumer protections to general advice.

Should all financial services entities that maintain an approved product list be required to comply with the obligations contained in FSC Standard No 24: Life Insurance Approved Product List Policy? (Q 12)

81. ASIC endorses the principles of competitive access and choice for consumers in relation to life insurance products. Accordingly, the introduction of some rules concerning approved products is, in general terms, a positive step. However, in ASIC's view, placing rules concerning the number of insurers to be included on an approved products list would not provide an entire solution, particularly given the fact that there are a limited number of products in life insurance and a limited number of life insurers. If an advisor is conflicted, or favours a particular product issuer, it is more likely that consumers will be sold products from that issuer even if approved product lists with a wider range of products are kept.⁴⁵

PART D. ADD-ON INSURANCE

Should the sale of add-on insurance by motor dealers be prohibited? (Q 13)

82. ASIC supports the implementation of the design and distribution obligations and the product intervention power which will likely limit the sale of unsuitable products and in exceptional circumstances may require a product to be banned (see response to question 2).

⁴⁵ ASIC Report 562, 'Financial advice: Vertically integrated institutions and conflicts of interest' (January 2018).

83. ASIC does not support a ban on the sale of add-on insurance (only) through a particular sales channel, in this case by motor dealers. While motor dealers are the main sales channel for add-on insurance products offered with motor vehicles, a prohibition that only applies to one channel is likely to result in distortions or regulatory arbitrage. For example, motor dealers could develop models in which these products are sold by a third party physically present on site, with the motor dealer receiving a share of the payments made by the insurer to that third party. Conversely, improvements to design and pricing would benefit all consumers, irrespective of the sales channel.
84. ASIC therefore considers that the poor outcomes identified in respect of the sale of add-on insurance products offered with vehicles would be better addressed through other mechanisms than by a ban on their sale by motor dealers. These include:
- a. a ban on conflicted remuneration (see Question 7);
 - b. the introduction of a deferred sales model (see Question 14); and
 - c. improved and targeted supervision (see Question 9).
85. ASIC considers that the combination of these changes should result in improvements to consumer outcomes including: reductions in prices; higher claims ratios; fewer sales of policies to consumers who are unlikely to benefit; and fewer unfair sales.
86. If these changes did not result in substantial improvements to consumer outcomes then ASIC would consider using the product intervention powers (assuming they are available) to prohibit the sale of add-on insurance products offered with vehicles.

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

87. ASIC's view is that add-on insurance should only be sold under a deferred sales model. The deferred sales model should be designed to both mitigate the factors that currently inhibit good consumer decision making and to also enhance competition (including by allowing for the possible development of an alternative online market for these products). A 'pause' in the sales process will at least provide consumers with more time to decide whether to purchase add-on insurance products, and to shop around before making that choice.
88. In August 2017, ASIC released a consultation paper (CP 294) seeking feedback on its proposal to implement a deferred sales model for the sale of add-on insurance and warranties through car yard intermediaries.⁴⁶

⁴⁶ See ASIC 17-280MR, 'ASIC consults on reforms to add-on insurance sales to drive better outcomes for consumers' (August 2017).

89. ASIC proposes to implement a deferred sales model primarily by using its existing statutory powers to modify provisions of the Corporations Act. ASIC will also consider using any product intervention powers, if and when these reforms are enacted.
90. ASIC intends to conduct further consultation before finalising the details of a deferred sales model. The design of the deferred sales model should specifically address the problems in existing sales methods.
91. Subject to that consultation, ASIC considers a deferred sales model should be comprehensive in coverage and therefore apply across: all classes of add-on financial products, including insurance and non-insurance products (such as warranties), to the extent permitted by ASIC's legislative powers; and all sales channels where intermediaries regularly arrange finance for cars (including car dealers, finance brokers and salary packaging firms).
92. Consumer engagement should be maximised so that:
- a. the deferral period would only commence after the consumer has expressed a clear preference for a particular vehicle (as if it started earlier they would still be focussing on the motor vehicle, rather than the add-on products);
 - b. the consumer should be able to access information online (after they have left the car dealer) that is designed to help them to make informed decisions;
 - c. the consumer should only be able to be sold the product if they have indicated a preference to do so through the online portal;
 - d. product providers should develop screening or 'knock out' questions so that consumers are not offered products where they are unlikely to benefit (either because the likelihood of a claim is very low or because the amount they would receive in the event of a claim is insignificant).
93. The Productivity Commission has expressed support for ASIC to introduce a mandatory deferred sales model for all sales of add-on insurance by car dealerships.⁴⁷

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

94. ASIC supports the introduction of a deferred sales model for all consumer credit insurance products sold as add-on insurance in all sales channels by all distributors including online.

⁴⁷ See Productivity Commission, 'Report on competition in the Australian financial system' (3 August 2018), Recommendation 14.1

95. In 2017, a deferred sales model was proposed for the sale of add-on consumer credit insurance (CCI) products sold with credit card and personal loans over the phone and in branches.⁴⁸ The change was introduced in the new Banking Code of Practice which was approved by ASIC on 31 July 2018.⁴⁹ The new Code will commence operation from 1 July 2019.

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? (Q 16)

96. If the ban on conflicted remuneration is not extended to apply to general insurance products ASIC's view is that it would be preferable to prohibit the payment of commissions to motor dealers and to other intermediaries who sell add-on financial products.
97. ASIC considers that it is appropriate to ban commissions because of:
- a. the general concerns in respect of conflicted remuneration identified in response to Questions 7, 8 and 9; and
 - b. the experience with the cap on commissions for consumer credit insurance (CCI) products at 20% of the premium in the Credit Act (the 20% cap), and the previous statutory embodiments of that restriction in the State and Territory Uniform Consumer Credit Codes.
98. In ASIC REP 470, released in February 2016, ASIC expressed the view that the problems in this sector were systemic and primarily the result of 'reverse competition' (that is, insurers were competing for access to car dealer networks to sell their products, which led to dealers demanding higher payments or commissions, driving up the cost to consumers and eroding the value offered by their products).
99. It is an uncompetitive market as in practice consumers are only offered a choice between buying or not buying the add-on products offered to them by the car dealer, rather than being able to shop around and choose between products offered by different insurers.
100. A cap linked to the amount of the premium can provide perverse outcomes including: higher prices as a mechanism to increase the commission in dollar terms (noting that consumers buying add-on products are less likely to be price-sensitive in their purchasing decisions); and an increase in penetration rates (including therefore an increased risk of sales to

⁴⁸ See ASIC 17-255MR, 'Banks to overhaul consumer credit insurance sales processes' (August 2017). CBA announced its intention to cease selling these products in March 2018, <https://www.commbank.com.au/guidance/newsroom/cci-and-pl-program-201803.html>.

⁴⁹ See ASIC 18-223MR, 'ASIC approves the Banking Code of Practice' (July 2018).

consumers who are not eligible to claim under the policy or unlikely to benefit from the product).

101. ASIC's findings in relation to the sale of life insurance products by car dealers provide evidence of both these outcomes and demonstrate that a value-based cap (set at 20% of the premium) has not worked.⁵⁰
102. ASIC compared the difference in price between two similar products, life cover under a CCI policy and term life insurance, both providing cover of \$50,000 over a four year period. It found that:
 - a. for a low-risk insured, a 20-year-old female non-smoker, the cost of life cover under a CCI policy was on average five times more expensive than term life cover; and
 - b. for a medium-risk insured, a 40-year-old male smoker, the cost of life cover under a CCI policy was over 1.6 times more expensive.⁵¹
103. ASIC also found that in the 2013–14 financial year, around 11% of car yard life insurance policies were sold to consumers aged 21 and under, whose need for a life insurance product is questionable given that they are less likely to have dependants, and are likely to have sufficient life insurance to discharge their liabilities through their superannuation fund (because of the MySuper arrangements).⁵²
104. ASIC considers that a complete ban on commissions would reduce the incentives to mis-sell these products. If a ban is imposed, it should apply to all add-on products sold in connection with a new or used car (tyre & rim, extended warranty, GAP), and should apply irrespective of the distribution channel (eg motor dealers, finance brokers). ASIC's view is that a ban on commissions would complement the introduction of a deferred sales period in reducing consumer harm, rather than be an alternative to it.

PART E. CLAIMS HANDLING

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? (Q 17)

105. ASIC considers that the obligations in s 912A of the Corporations Act should apply to all aspects of the provision of insurance, including claims handling and settlement. To this end, it supports the inclusion of claims handling as a "financial service" for the purpose of s 912A.

⁵⁰ ASIC Rep 471 at [132].

⁵¹ ASIC Rep 471 at p 17.

⁵² ASIC Rep 471 at p 8 (Table 1).

106. Currently, giving financial product advice or dealing in an insurance product in the course of, or as a necessary or incidental part of, the handling or settlement of claims or potential claims is explicitly excluded from the definition of a financial service for the purpose of s 766A(2) of the Corporations Act by r 7.1.33 of the *Corporations Regulations 2001*.
107. The current legislative framework for defining financial services that are regulated under the Corporations Act restricts ASIC's ability to take action for conduct such as:
- a. 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;
 - b. inappropriate claims handling practices such as those highlighted in the TAL case studies examined by the Commission in this round of hearings;⁵³ and
 - c. unnecessary or extensive delays in handling claims.⁵⁴
108. ASIC considers that the exemption for 'handling insurance claims' in r 7.1.33 from the conduct provisions of the Corporations Act should be removed, and the definition of financial services expanded to cover conduct involved in the claims handling process. Specific standards or obligations in relation to claims handling should also be considered. ASIC also considers that more significant penalties for misconduct in relation to insurance claims handling should be included in ASIC's penalty powers.

**Should ASIC have jurisdiction in respect of the handling and settlement of insurance claims?
(Q 18)**

109. ASIC considers that its powers in relation to the regulation of insurance products should cover claims handling and settlement.
110. The limitations on ASIC's powers means ASIC is unable to take action in relation to claims handling. For consumers, the intrinsic value of an insurance product lies in the ability to make a successful claim when an insured event occurs. When insurers act unfairly in claims handling, ASIC is limited in the regulatory interventions it can take.
111. ASIC has power under s 14A of the ICA to take licensing action if there has been a breach of the duty of utmost good faith in the handling of a claim, but sanctions such as penalties are not available for breaches of this obligation. ASIC supports the Enforcement Review Taskforce recommendation that civil penalty action be available to ASIC for breaches of the duty of utmost good faith.

⁵³ T6481.45.

⁵⁴ See ASIC 18-188MR, 'ASIC takes civil penalty action against AMP Financial Planning for alleged failures relating to insurance advices' (June 2018).

112. There are other limitations to using the duty of utmost good faith provisions in the ICA:
- a. ASIC's powers in s 14A are limited to licensing action, which means suspending, cancelling, or imposing condition on a licence (only in relation to contracts entered into from 2013);
 - b. ASIC can intervene in existing Court proceedings under the ICA in relation to a breach of the duty, but there would need to be existing proceedings on foot for ASIC to intervene in;
 - c. ASIC can also take representative action, but the consent of the parties is required for this.
113. In enhancing ASIC's powers in relation to insurance claims handling, the role of superannuation trustees should be considered. A significant proportion of life insurance claims relate to group policies held by superannuation trustees on behalf of their members (over 70% of life insurance cover). The role of trustees and their existing duties and obligations should be considered when designing a claims handling regime.

Should life insurers be prevented from denying claims based on the existence of a pre-existing condition that is unrelated to the condition that is the basis for the claim? (Q 19)

114. Life insurers should not be allowed to deny claims based on the existence of a pre-existing condition which is unrelated to the condition giving rise to the claim
115. In ASIC REP 498, ASIC identified that insurers are presently able to deny a claim based on a pre-existing condition unrelated to the claim.
116. Insurers' entitlement to deny claims based on unrelated pre-existing conditions arises under the ICA, in particular the duty of disclosure in s21 and the three-year rule in s29(3) for non-fraudulent failure to disclose or non-fraudulent misrepresentation. Section 21 of the ICA requires policyholders to disclose matters that they know, or that a reasonable person in their circumstances would be expected to know, is material to the insurer's decision to accept insurance.
117. As long as insurers are simply able to avoid a contract within 3 years for any type of non-fraudulent failure to disclose or 'innocent' misrepresentation, insurers are incentivised to look widely for reasons to avoid a contract at the time a claim is made, rather than focusing on the merits of the specific claim, supporting their customer during the claims process and providing the service the customer reasonably expects after having paid premiums up to that point. The three-year rule in particular appears to encourage the kind of 'fishing expedition'

by insurers that was highlighted in one of the TAL case studies examined during the Round 6 hearings.⁵⁵

118. Additionally, for underwritten policies, insurers have an opportunity to examine applicants and deny or limit cover at the outset, based on their pre-existing health.

Should life insurers who seek out medical information for claims handling purposes be required to limit that information to information that is relevant to the claimed condition? (Q 20)

119. For the same reasons that life insurers should not be permitted to deny claims based on unrelated pre-existing conditions, any inquiries as to the existence of pre-existing conditions should be limited to inquiries about the condition giving rise to the claim.
120. As noted above, the provisions relating to non-disclosure in the ICA presently provide an incentive to insurers look more broadly into a claimant's medical history and seek to avoid a claim when it is made within 3 years of the policy's inception. These provisions effectively encourage the insurer to make broad inquiries into the claimant's previous disclosure.
121. In ASIC REP 498, ASIC raised concerns about an alleged practice of insurers obtaining access to policyholders' personal Medicare billing data dating back several decades to identify pre-existing conditions that were not disclosed in order to enable the claims to be denied.
122. ASIC shares the concerns raised by medical professional bodies in the Parliamentary Joint Committee Inquiry into the Life Insurance Committee.

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 current 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? (Q 21)

123. ASIC has commenced a review of the use of surveillance practices in claims management. In ASIC's view, the current regulatory requirements are not sufficient to ensure that surveillance is only used appropriately and will not cause harm to the insured.

⁵⁵ T5680.43-T5681.43.

124. The exclusion of claims handling from the definition of a financial service for the purpose of the Corporations Act restricts ASIC's ability to take action for conduct in relation to surveillance practices by investigators, as noted in ASIC REP 498.
125. ASIC supports the development of specific and prescriptive conduct standards for surveillance, including a requirement that insurers provide documented reasons for carrying out surveillance and restricting or prohibiting the use of surveillance for mental health claims. In ASIC REP 498, ASIC observed that at least one insurer has publicly stated that it no longer uses surveillance in the assessment of claims related to mental illness.
126. Although it is recognised that insurers must use fraud management systems to ensure that only genuine claims are accepted, the vulnerability of claimants with a mental health condition must be considered as a part of these systems, as should the probative value of a surveillance for these types of claims.

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

- **act fairly; and**
- **ensure that the policyholder is indemnified against the loss insured (as, for example, by being able to complete all necessary repairs)? (Q 22)**

127. ASIC considers that claims handling (which would include cash settlement arrangements) should be included as a 'financial service' for the purpose of the Corporations Act and therefore subject to the obligations in s 912A and potentially other obligations. This will assist ASIC to regulate this area by enhancing the powers available to take action and the standards applicable to the service.
128. Given the issues that have emerged in evidence before the Royal Commission, it appears that minimum industry standards would help to ensure insurers act fairly and reasonably when proposing or agreeing to cash settlements.
129. ASIC considers that total replacement policies can help to reduce the risk of underinsurance for consumers, even where cash settlements are provided. However, it is not apparent that indemnification against loss is always appropriate, as this will depend on what the insurer has offered in the insurance policy, which will then be priced accordingly in the premium charged to the customer based on the level of cover selected. Generally, full indemnity policies will be more expensive than agreed value cover. For a consumer who selects a total replacement cover policy, they are entitled to expect to be able to be covered against a total loss, without the risk of having selected a sum insured amount that may result in a shortfall

against the loss suffered. However, identifying the proper payment to address a total loss is necessarily imprecise and involves a degree of estimation.

130. It therefore seems appropriate to require of insurers standards of fairness, transparency and accountability in settling claims, in particular when arranging cash settlements. Insurers should consider mandating industry standards on these issues including for instance, requiring insurers to provide consumers with a copy of all quotes that the insurer receives when determining the cash settlement amount, allowing the consumer to obtain and submit their own quote to be considered as part of any cash settlement process, and ensuring there is prompt, consistent and effective communication with the claimant through the claims handling process.
131. ASIC is also concerned that cash settlements may reflect the lowest quote in circumstances where quotes may vary widely, and where the quotes received by the insurer are not disclosed to the insured. ASIC's ability to take action in relation to this issue is limited due to the exclusion of 'claims handling' from the definition of financial services. However, a requirement for the insurer to act fairly when there are widely diverse quotes could assist as the insurer might be required to obtain further quotes to determine a reasonable cost, or offer the consumer a cash settlement based on an average quote rather than the lowest cost.

PART F. INSURANCE IN SUPERANNUATION

Should universal:

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

be prescribed for group life policies offered to MySuper members? (Q23)

132. There can be significant benefits for consumers from the use of standardisation in minimum coverage requirements, definitions and exclusions. This was highlighted in ASIC Report 591 ('Insurance in Superannuation' (**ASIC REP 591**)), released by ASIC in September 2018.
133. As noted above, ASIC has identified that consumers are not always able to identify and appreciate how differences in terminology between policies will affect coverage under those policies. Standardised terms and definitions would improve comparability of products which would make it easier for members to understand and exercise informed choices about their cover.

134. ASIC considers that the Insurance in Superannuation Voluntary Code of Practice (*Insurance in Super Code*) is a potential mechanism to achieve this standardisation, but it has limitations (discussed below).
135. As outlined in ASIC’s submission to Round 5, ASIC is strongly in favour of additional, and stronger, criteria for MySuper products, and considers that this should include specific requirements relating to insurance.⁵⁶
136. However, further work is required to identify whether understanding of insurance cover should be promoted by having specific minimum coverage requirements, definitions or exclusions, some only of these or by taking another approach. Demographic, actuarial and balance erosion considerations would all be relevant. As outlined below, however, ASIC’s view is that adherence to clear standards about what constitutes “permanent incapacity” is necessary.
137. As stated in ASIC’s submission to the Productivity Commission’s draft report on the efficiency and competitiveness of the superannuation system, ASIC considers that an independent review of insurance in superannuation (identified in the draft recommendations of the Productivity Commission) should be prioritised. This independent review could consider what further requirements, including any minimum coverage requirements, definitions and exclusions, should be prescribed.

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)? (Q 24)

138. The definition of “permanent incapacity” referred to above is important for the obligation imposed on superannuation trustees in s.68AA of the SIS Act to provide permanent incapacity benefits as well as providing an outer limit on circumstances in which group insurance cover can be used to meet claims for all superannuation members of RSEs.⁵⁷
139. As outlined above in response to question 23, ASIC agrees that consideration should be given as to whether a minimum coverage requirement should be imposed for MySuper products. ASIC also has particular concerns about the value of TPD insurance cover inside

⁵⁶ ASIC notes the requirement prescribing a minimum level of death cover for a MySuper member in s 9A and Schedule 1 of the *Superannuation Guarantee (Administration) Regulations 1993*. In ASIC’s view, further and stronger requirements would be beneficial.

⁵⁷ *Superannuation Industry (Supervision) Regulations 1994*, 4.07D.

superannuation when the claimant is assessed under the activities of daily living (ADL) or activities of daily work (ADW) tests, as noted above.

140. The definition in regulation 1.03C provides an appropriate conceptual articulation of circumstances in which permanent incapacity insurance should be provided if it is to be offered as part of the MySuper product. However, further consideration of standardisation should take place within the context of the broader insurance review as proposed by the Productivity Commission.

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)? (Q 25)

141. Yes, this obligation should be imposed on RSE licensees.
142. In contrast to individual life insurance, group insurance is designed to be offered across a wide group of people and there is limited statistical information collected for the purposes of allocating premiums. This will be reflected in the terms of the insurance policy negotiated with the insurer. These insurance policies differ (eg some will have terms that apply particular coverage for smokers only if identified as such, whereas others will not necessarily have this provision meaning that identification of whether someone is a smoker is not necessary for the purposes of ensuring that the person is covered by the policy).
143. To the extent that there are defaults that operate in a way that increase premiums embedded in the group insurance policy, RSE Licensees should ensure that their members are defaulted to statistically appropriate rates for insurance required to be offered through the fund. For instance, if the demographics of the fund membership are such that 90% of them are blue collar workers then defaulting someone as a blue collar worker obliged to pay higher premiums is appropriate, whereas if only 10% are blue collar workers then defaulting in this manner is not appropriate.
144. As outlined in ASIC REP 591 default settings may unfairly increase insurance premiums and significantly affect the size of the member's superannuation benefit. ASIC considers that it is important for trustees to develop and update their records, and understand the composition and different needs of their membership, to assess and justify why these default settings are in the best interests of their membership. This is particularly so for disengaged members who are less likely to be aware of a transfer, any default and its consequences. ASIC is undertaking ongoing work in relation to trustee insurance default practices.
145. For some characteristics which may affect premiums (such as age or gender), it may not be appropriate to use any kind of default or assumption. Instead, a trustee exercising the requisite

level of care, skill and diligence should implement procedures to obtain and, if they become aware that their records are incorrect, to update their records about a member's characteristics. ASIC considers that there may be benefits from trustees being subject to clearer obligations or expectations in this respect.

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

146. There are clear conflicts of interest that arise around engaging a related insurer for a superannuation fund. However, it is difficult to conclude that a general prohibition on engaging an associated entity as a group life insurer is desirable. There may be benefits for consumers from using an associated entity as the fund's insurer, particularly if the associated entity offers a well-designed insurance product that is well priced.

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? (Q 27)

147. ASIC refers to its comments on managing conflicts in its submission to Round 5. In particular:

- a. ASIC supports a more comprehensive review of potentially conflicted structures in superannuation to see if particular structures are sustainable and the costs and benefits of these structures. ASIC would support the inclusion of engaging an associated entity as the fund's group life insurer as part of that review;
- b. one issue that might be usefully explored through such a review is whether there should be a reversal of 'onus of proof' in relation to related party arrangements. That is, such arrangements are assumed to be contrary to the best interests of members unless the contrary is proved. This might also be an appropriate standard to be applied to engaging a related party insurer, and this 'benchmarking' should be clearly documented with the expectation that such an argument in favour of a related insurer could be made public; and
- c. there may also be a role for greater transparency around decisions and structures that give rise to conflicts of interests, including decisions to engage an associated entity as the fund's group life insurer.

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? (Q 28)

148. ASIC considers that industry codes can raise industry standards, support the complaints process and provide certainty for consumers. However, this requires terms that make a real difference to outcomes for consumers and appropriate implementation of those terms throughout the industry.
149. While the Insurance in Superannuation Code has a number of provisions that if implemented will improve the position of fund members, ASIC notes that in relation to the terms of the Code:
- a. a significant number do no more than articulate existing law and, if the Government's Protecting Your Super Package is legislated, some parts of the Code will be superseded by these changes;
 - b. there may be improvements or additional terms that may assist in furthering the interests of fund members, for instance in relation to the treatment of vulnerable consumers, an expanded definition of "automatic insurance members" to ensure particular protections apply more broadly and standardisation of insurance definitions; and
 - c. as implementation of the Code is still in early stages the effectiveness of the terms in practice has not yet been explored.
150. In addition, the Insurance in Superannuation Code has significant weaknesses that limit its potential effectiveness:
- a. **Coverage:** Codes are most effective where they have broad coverage across the industry. Given the fragmented nature of superannuation entities and industry representative associations, it is likely that full coverage of the Insurance in Superannuation Code will only be achieved if code membership is made mandatory.
 - b. **Administration and Enforcement:** The Insurance in Superannuation Code is voluntary and trustees that elect to adopt it are only required to comply on an 'if not, why not' basis. Trustees are responsible for monitoring and reporting on their own compliance, and there is no code monitoring body or administrator. Typically, codes have an independent and appropriately resourced body to monitor and enforce the code, and ensure that the code is effectively linked to a dispute resolution scheme. That is, an enforceable code is ideally binding via contractual arrangements and where the code administrator is responsible for enforcement. The fragmented nature of industry

associations in superannuation will pose challenges in achieving such arrangements for insurance in superannuation.⁵⁸

151. The Insurance in Superannuation Code commenced on 1 July 2018 but contemplates gradual adoption of the code by trustees up to 30 June 2021. ASIC will work with APRA to monitor the adoption of the Insurance in Superannuation Code across the sector over the remainder of 2018 to understand its impact and if there is scope for improvement. In particular, ASIC will be interested to see whether the superannuation industry can collectively commit to the establishment of a properly resourced code administrator to appropriately enforce the Code, especially given the challenges noted above.

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

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? (Q 29)

152. The existing unfair contract terms (UCT) provisions in the ASIC Act should be extended to standard form contracts for general and life insurance. This is because the ASIC Act includes the core consumer protection provisions that should apply to all financial products and services, whether or not those products are more specifically regulated under other legislation, and will ensure the greatest level of harmonisation between insurance products and other financial products.
153. ASIC supports extending UCT protections to insurance contracts because life and general insurance products are important risk management tools for consumers and small businesses to protect their living standards and assets. Accordingly, consumers and small businesses are entitled to be confident that the standard form insurance contracts they are offered are fair because such contracts are usually offered on a “take it or leave it” basis, with no ability for consumers or small business to negotiate the terms of insurance contracts.
154. In ASIC’s view, extending UCT protections to these insurance contracts:
- a. would give life and general insurance policyholders the same protections that are currently available for other financial products and services and other standard form contracts throughout the economy;
 - b. will require insurers to review their standard form contracts and proactively address any terms that could be unfair;

⁵⁸ This would remain the case if the Government implements the recommendations of the ASIC Enforcement Review Taskforce Report which recommends that should be binding on and enforceable against subscribers by contractual arrangements with a code monitoring body (Recommendations 20).

- c. can play an important role in promoting trust and integrity in the insurance sector;
- d. when appropriately tailored to the specific features of insurance contracts, can help protect consumers and small businesses while still accommodating the legitimate interests of insurers; and
- e. will allow the Australian Financial Complaints Authority (**AFCA**) to consider unfair contract terms when determining complaints.

155. ASIC considers that it is necessary to tailor some of the UCT provisions to respond to the specific features of insurance contracts. To this end, ASIC considers that:

- a. the “main subject matter” exemption should be narrowly defined in relation to insurance contracts to ensure an appropriate balance between the legitimate business interests of insurers while addressing the power imbalance faced by consumers dealing with standard form contracts;
- b. an insurance contract’s premium should be included with the quantum of any excess payments within the definition of “upfront price” of an insurance contract (therefore exempting this quantum from the UCT regime);
- c. a tailored unfairness test for insurance contractual terms should be applied to defining an insurer’s “legitimate interests”, with that concept having two elements: first, that the term reasonably reflects the underwriting risk accepted by the insurer in relation to the contract and, second, that it does not disproportionately or unreasonably disadvantage the insured or third party beneficiary; and
- d. the concept of “standard form contract” should include contracts that consumers and small businesses have chosen from various policy options.

156. In addition to these measures, ASIC considers that further consideration should also be given to the range of remedies that are available when it is found that an insurance contract includes an unfair term, as the voiding of a term may not always provide a suitable or effective remedy in an insurance context.

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? (Q 30)

157. The duty requires ‘each party to it to act towards the other party, in respect of any matter arising under or in relation to it, with the utmost good faith’. As the external dispute resolution (**EDR**) body is not a party to the contract the obligation would not apply directly to the

insurer's dealings with that body. However, the obligation would require the insurer to deal with the insured (or third party beneficiaries) in good faith during the EDR process.

158. It would be preferable to clarify the position in the ICA to confirm that the duty would apply to this conduct,⁵⁹ noting the comments about the shortcomings of the duty of utmost faith in response to Question 18.
159. Section 1052E(1) of the Corporations Act requires that AFCA must give particulars of a contravention, breach, refusal or failure to ASIC, APRA or the ATO as appropriate, if it becomes aware, in connection with a complaint under the AFCA scheme that, among other things, a serious contravention of any law may have occurred, or a party to the complaint may have refused or failed to give effect to a determination made by AFCA. This means that serious contraventions must be reported by AFCA to ASIC and this could include circumstances which are a breach of the duty of utmost good faith.

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? (Q 31)

160. While ASIC does not have sufficient evidence to determine whether the amendments to the ICA in 2013 have resulted in an “avoidance regime”, it has recently obtained evidence to suggest that some insurers may be making greater use of s 29(3) to avoid contracts than other insurers. Data obtained for ASIC's thematic review of TPD claims shows that for 2 out of 7 target insurers, 8% of claims they declined in 2016 and 2017 were for “innocent non-disclosure” (compared to 0%-2% for the other 5 insurers). Although it appears only a relatively small number of consumers are having their claims declined under the current ICA regime, the harm done to these consumers may be significant and, in ASIC's view, is not warranted.
161. Some judicial commentary supports the view that the current provisions in the ICA concerning the disclosure tilt the balance unfairly in favour of the insurer and against the consumer. For example, in *Preston v AIA Australia Ltd*, the Court of Appeal of New South Wales upheld the insurer's reliance on a pre-existing condition to partially decline a TPD claim.⁶⁰ Despite the ultimate conclusion, Gleeson JA noted that the restrictive policy wording may not have adequately been brought to the attention of the insured, stating:⁶¹

⁵⁹ Australian Financial Complaints Authority Complaint Resolution Scheme Rules (effective from 1 November 2018) (**AFCA Complaint Resolution Rules**).

⁶⁰ [2014] NSWCA 165.

⁶¹ [2014] NSWCA 165 at [5] (Gleeson JA).

“Whether the [insured] was misled when taking out the Policy was not an issue in these proceedings; nor was it argued that the insurer’s conduct in apparently failing to draw the insured’s attention, in clear and plain language, to the restrictive terms of cover provided under the Policy might have constituted unconscionable conduct. Hence these possible avenues for ameliorating what may seem a harsh result were not open to the Court below or on appeal.”

162. This passage suggests that at least one member of the Court (Gleeson JA) considered that the onus should also have been on the insurer to disclose the policy terms more clearly, and was concerned as to the sufficiency of the disclosure (identifying the appellant’s “sense of grievance” as “readily understandable”).⁶² The question of what reform may be needed is addressed in answer to Question 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)? (Q 32)

163. In ASIC’s view, an insured’s duty of disclosure remains important in the context of fraudulent non-disclosure and fraudulent misrepresentation but ought to be less relevant in the context of non-fraudulent non-disclosure, especially as insurers use more sophisticated data modelling and data-driven underwriting. These tools should enable better pricing of risk to potentially obviate the need for retrospective underwriting of a claim, or avoidance of a contract, based on non-fraudulent failure to disclose. The harm done to consumers by reason of the current deficiencies in the provisions of the ICA is not warranted and consideration should be given to removing remedies for non-fraudulent misrepresentation/non-disclosure that allow an insurer to avoid the relevant contract of insurance.
164. To this end, ASIC notes that the *Consumer Insurance (Disclosure and Representations) Act 2012 (UK)* (the **UK legislation**) imposes a duty on consumers to take “reasonable care” not to make a misrepresentation and gives guidance about what is meant by “reasonable care”. This guidance puts some onus on the insurer to ask clear and specific questions of the consumer when offering insurance. ASIC considers that there is some merit in this approach, especially to the extent that the onus is placed on insurers to offer adequate disclosure to consumers. The legislation in the United Kingdom still allows an insurer to avoid a contract for “careless misrepresentation” by the consumer and such a remedy does not appear to be time-limited, which can be distinguished with the three-year rule in the ICA.

⁶² [2014] NSWCA 165 at [6] (Gleeson JA).

165. Accordingly, if it were thought appropriate to adopt aspects of the United Kingdom model, ASIC would recommend that closer consideration is given to the effectiveness of that legislative regime in the period since the introduction of the UK legislation (with particular attention to the nature and volume of litigation concerning the concept of “careless misrepresentation”).

PART H: REGULATION

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? (Q 33)

166. In Regulatory Guide 183⁶³, which gives guidance about ASIC’s approach to approving codes, ASIC records an expectation that code applicants be able to show that their subscribers cover a majority of participants in the relevant sector. ASIC acknowledges the Enforcement Taskforce⁶⁴ position that entities engaging in activities covered by an approved code should be required to subscribe to that code.

167. ASIC would support the extension of each of the Life Insurance Code and the General Insurance Code to all relevant insurers whose business is covered by the ambit of the Code. ASIC does not consider that there is any logical basis upon which some insurers should be exempt from the application of these codes, or subject to a less stringent self-regulatory regime. In any event, even if these codes did not formally apply to all insurers, they would be applied in determining a consumer dispute. The AFCA Rules state that when determining a complaint, the AFCA Decision Maker must do what the AFCA Decision Maker considers is fair in all the circumstances having regard to, among other things, applicable industry codes or guidance and good industry practice (which would in theory be informed by code provisions)⁶⁵.

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

- **a failure to comply with financial services laws (for the purpose of section 912A of the Corporations Act 2001 (Cth));**
- **a failure to comply with an Act (for example, the Corporations Act 2001 (Cth) or the Insurance Contracts Act 1984 (Cth))? (Q 34)**

⁶³ RG 183 at para183.39

⁶⁴ ASIC Enforcement Review, Position and Consultation Paper 4 – Industry codes on the financial sector, Submissions on behalf of Australian Securities and Investments Commission at Part B.

⁶⁵ AFCA Complaint Resolution Rules, A.14.2(b) and (c)

168. ASIC supported the Enforcement Taskforce's Position 3, expressed in its Position and Consultation Paper 4, that approved codes should be binding on and enforceable against subscribers by contractual arrangements with a code monitoring body.⁶⁶
169. With effective monitoring and enforcement arrangements, industry codes can support the dispute resolution process and provide certainty for consumers about the conditions under which financial products and services are provided. However, whether industry codes can deliver enhanced consumer outcomes ultimately depends on the underlying conduct standards that each code sets.
170. While treating a failure to comply with the Life Insurance Code or the General Insurance Code as a failure to comply with a financial services law for the purposes of s 912A of the Corporations Act may have merit and may, in particular, enhance the enforcement of minimum standards across industry, it would mean that the code is not a self-regulatory instrument.
171. Any legislative reform of this kind needs to be properly considered in the context of ASIC's other powers, the broader regulatory obligations placed on licensees and the capacity of the standards in each code to be sufficiently specific in order to be enforceable. This is because treating a failure to comply with the Life Insurance Code or the General Insurance Code as a failure to comply with a financial services law for the purposes of s 912A of the Corporations Act would involve a significant shift in the status of industry codes within the broader regulatory framework.

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? (Q 35)

172. Effective regulation depends on achieving enforcement outcomes that act as a genuine deterrent to misconduct.⁶⁷ Accordingly, there is a need for ASIC to be able to impose sanctions that are both graduated and flexible, allowing it to respond in a proportionate manner to different levels of seriousness of misconduct.⁶⁸ One such sanction is the infringement notice.

⁶⁶ ASIC Enforcement Review, Position and Consultation Paper 4 – Industry codes on the financial sector, Submissions on behalf of Australian Securities and Investments Commission at [47].

⁶⁷ ASIC Enforcement Review, Position Paper 7 – Strengthening penalties for corporate and financial sector misconduct, Submissions on behalf of Australian Securities and Investments Commission at [205].

⁶⁸ ASIC Enforcement Review, Position Paper 7 – Strengthening penalties for corporate and financial sector misconduct, Submissions on behalf of Australian Securities and Investments Commission at [205].

173. ASIC is currently able to issue infringement notices for contraventions of certain consumer protection provisions in the ASIC Act and for breaches of strict liability offences, as well as breaches of certain civil penalty provisions of the *National Consumer Credit Protection Act 2009* (Cth) (**Credit Act**) and the Corporations Act, and for breaches of the Market Integrity Rules, the Derivative Transaction Rules and the Derivative Trade Repository Rules.

174. Infringement notices have the following benefits:

- a. they increase the likelihood that contraventions will be penalised⁶⁹ 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. In doing so they can improve consumer outcomes by changing the behaviour of individual firms and by increasing general deterrence and encouraging voluntary compliance;⁷⁰
- b. they enable ASIC to signal to the market *easily and quickly* that particular conduct constitutes a contravention of the law,⁷¹ by enabling ASIC to more efficiently and effectively take action in relation to conduct that warrants sanction but is relatively less serious. Thus they can inform the market of specific situations where ASIC expects a change in conduct, such as concerns about how the benefits of a particular insurance product are promoted;
- c. they provide ASIC with more flexibility in terms of the enforcement tools it may use to deal with contravening conduct,⁷² enabling ASIC to target its response to contraventions to the tenor of the conduct and to the circumstances of different entities;⁷³ and
- d. while financial penalties for infringement notices are substantially lower than penalties resulting from civil and criminal proceedings taken by ASIC, the public impact of infringement notices can act as an additional deterrent and can encourage compliance.⁷⁴

175. However, if an amount payable under an infringement notice is too low, it will be an inadequate deterrent and may simply be paid by the guilty and innocent alike as a "cost of

⁶⁹ Explanatory Memorandum, CLERP 9 at [4.255], Explanatory Memorandum, *National Consumer Credit Protection Act 2009* at [9.50].

⁷⁰ M Welsh, 'Enforcing contraventions of the continuous disclosure provisions: Civil or administrative penalties', *Company and Securities Law Journal*, 25 (2007) at p 315.

⁷¹ Explanatory Memorandum, CLERP 9 at [5.458].

⁷² Second Reading Speech, CLERP 9; Explanatory Memorandum, *Trade Practices Amendment (Australian Consumer Law) Act (No.1) 2010* at [8.4]

⁷³ Explanatory Memorandum, *National Consumer Credit Protection Act 2009* at [4.35] to [4.38].

⁷⁴ R G Morison and I Ramsay, 'Enforcement of ASIC's market integrity rules: An empirical study', *Australian Journal of Corporate Law*, 30 (2015), at p 32.

doing business". Care must be taken to ensure that infringement notice penalties are set at an appropriate ratio to the relevant maximum penalty for the underlying contravention.

176. ASIC supports increasing the number of penalty units that may be charged by an infringement notice, or any proposal to introduce “tiers” of infringement notices to respond appropriately to the level and character of the offence in question. ASIC sought higher and more extensive infringement notice penalties in its submissions to the Enforcement Review Taskforce.⁷⁵
177. In its submission responding to the Taskforce consultation paper ASIC argued that where a civil penalty provision is also an infringement notice provision, the infringement notice penalty should be one-fortieth the civil penalty maximum, as in the Credit Act – therefore in the Credit Act itself the current penalty of 50 penalty units (**PU**) for an individual / 250 penalty units for a body corporate would increase with the increase in the civil penalty maximum (of 5,000PU / 50,000PU) to 125PU / 1250 PU.⁷⁶
178. However, the Taskforce recommended an infringement notice penalty of 12 PU / 60 PU, which is the current penalty in the ASIC Act (except for the Credit Act recommended that the penalty remain at the current 50PU / 250 PU).⁷⁷ The Taskforce also recommended more extensive infringement notice penalties, but generally not as extensive as sought by ASIC.⁷⁸
179. ASIC understands that there may be a perception that infringement notices are not, at their current levels, always an appropriate or proportionate response in instances of misconduct. The amounts provided for under the various infringement notice regimes over which ASIC presides are all considerably lower than the maximum penalty allowed for in the legislation for contravention of the obligations themselves, in order to act as an incentive for the party to pay the infringement notice amount rather than litigate the matter. ASIC uses infringement notices as a regulatory tool in relation to less serious contraventions that it considers can be more efficiently and effectively dealt with in this way.
180. In ASIC’s view, an appropriate response to the perception that infringement notices are inadequate is to extend and strengthen the penalty that may be imposed through an infringement notice. That course is to be preferred over disallowing or abandoning the use

⁷⁵ ASIC Enforcement Review, Position Paper 7 – Strengthening penalties for corporate and financial sector misconduct, Submissions on behalf of Australian Securities and Investments Commission at [228]-[230].

⁷⁶ ASIC Enforcement Review, Position Paper 7 – Strengthening penalties for corporate and financial sector misconduct, Submissions on behalf of Australian Securities and Investments Commission at [224].

⁷⁷ *ASIC Enforcement Review Taskforce Report*, December 2017 at p 83 (**Taskforce Report**).

⁷⁸ ASIC Enforcement Review, Position Paper 7 – Strengthening penalties for corporate and financial sector misconduct, Submissions on behalf of Australian Securities and Investments Commission at [213]; Annexure D; Taskforce Report at p 81 and Table D.

of infringement notices, particularly given their benefits as an administrative and regulatory tool. ASIC supports an extension of the infringement notice regime to a broader range of misconduct, at amounts that optimise their deterrent effect as a proportionate response to lesser regulatory breaches.

PART I: COMPLIANCE AND BREACH REPORTING

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? (Q 36)

181. Section 912A of the Corporations Act sets out the general obligations for a financial services licensee. Section s 912A(1)(d) requires licensees to have available adequate resources (including financial, technological and human resources) to provide the financial services covered by the licence and to carry out supervisory arrangements. However s 912A(4) provides that this obligation does not apply to certain bodies regulated by APRA, relevantly, this includes life and general insurers.
182. Section 912A(1)(h) requires licensees to have adequate risk management systems. However s 912A(5) provides that this obligation also does not apply to certain bodies regulated by APRA relevantly, this includes life and general insurers.
183. In ASIC's view these two exclusions should be removed. The effect of these exclusions is that ASIC is not able to take action for a licensee's non-compliance with s 912A(1)(d) and (h).
184. Removing these exemptions would enable ASIC to become directly involved in the following areas - oversight and supervision of the:
 - a. adequacy of an insurer's (and certain other APRA regulated bodies') resources and supervision capabilities; this was an issue ASIC raised in REP 498 as a shortcoming to the operation of insurers and their claims handling operations;⁷⁹
 - b. defining, assessment and measurement of conduct risk for entities that are subject to prudential regulation (dual regulated entities). Currently ASIC has no role in defining, assessing and measuring risk – including conduct risk – for dual regulated entities, as this responsibility rests solely with APRA. This prevents ASIC from ensuring that conduct risk is effectively managed by dual regulated entities.
185. ASIC would use these powers in a considered way in close consultation with APRA; together the agencies could operate in a co-ordinated and complementary way to oversight dual

⁷⁹ ASIC Rep 498 at [44], [326]-[331], [335]-[336].

regulated entities' adequacy of resources and risk management systems. This would be analogous to the position in the United Kingdom with respect to the Financial Conduct Authority and the Prudential Regulation Authority.

186. Conduct risk (the risk of loss to firms and their customers flowing from poor conduct including failure to meet community expectations) should also be a separate category of risk explicitly measured and given sufficient priority in financial services entities' risk management frameworks and risk appetite statements. There should be no tolerance for conduct where it is reasonably foreseeable that the conduct could give rise to consumer harm.

ASIC also considers that risk management minimum standards and requirements about what constitutes an adequately staffed compliance function could be enhanced to include more descriptive minimum standards. 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:

- **preventing breaches of financial services laws and other regulatory obligations; and**
- **ensuring that any breaches that do occur are remedied in a timely fashion? (Q37)**

187. ASIC supports greater consequences for financial service licensees that fail to implement adequate and effective compliance systems. Licensees' systems can impact their ability to identify systemic issues, and their ability to manage risks—including investigating an incident, reporting a significant breach, and managing the rectification and remediation of significant breaches. Licensees need to invest in creating and maintaining systems that capture accurate, complete, and current information of the type required in a breach report and for remediation and that are searchable, updatable and extractable.

188. ASIC therefore supports the changes proposed in the ASIC Enforcement Review, which delivered recommendations for law reform in December 2017, including for the breach reporting obligation, with the purpose of creating stronger and clearer rules for reporting breaches to ASIC. ASIC also supports the additional and increased penalties recommended by the Taskforce for failure to comply with the breach reporting and other obligations of licensees, including their general obligations in s 912A of the Corporations Act. These obligations require, among other things, that licensees act efficiently, honestly and fairly in their dealings with clients. ASIC supports the imposition of a penalty for breach of this fundamental obligation.

189. ASIC requires a broad, effective range of enforcement remedies to enable it to respond to the full range of types and severity of misconduct, from less significant to more serious breaches. There are significant variations in the seriousness of breach reporting failures.⁸⁰

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? (Q 38)

190. ASIC considers that the leadership (including the board) of financial services entities should look to properly test the culture of their firms to ensure they have a culture that values compliance and aligns with good consumer outcomes. Where an entity identifies it has a poor corporate culture, it needs to identify what changes need to be made to address misaligned drivers of conduct, such as remuneration, or performance management. This, in effect, is a requirement under the law (s 912A) to act ‘efficiently, honestly and fairly’.
191. If these cultural problems are deeply embedded, then a major review may be required with independent assistance. The Royal Commission’s work has indicated that firms have at times failed to embed cultural improvements throughout the organisation, or that messages about better compliance are undermined by remuneration or performance benchmarks.
192. In ASIC’s experience, a more challenging and arguably more important issue arises where a financial services entity identifies that not only its own business, but that of the firms *across the sector* in which it operates, have a poor culture. This has been a regular experience across the financial services industry, for example in the payment of conflicted remuneration and benefits in the distribution of life insurance. In such cases, firms may effectively adopt an approach whereby ‘it’s alright if everyone else is doing it’, which can have a corrosive effect on culture. This reflects the pervasiveness of ‘collective action’ problems in complex financial markets, where firms are reluctant to be the first mover to confront compliance problems for fear of losing market share.
193. In such cases, it would be desirable to see individual firms seeking to take a more active role through industry associations and/or engagement with regulators or policy makers to help arrive at industry-wide reforms. However, this can be challenging in markets with diverse participants and where demand-side pressure is weak.
194. Regulators can help shape culture through engagement, negotiations, publicly naming entities and through enforcement. ASIC has focused on regulatory actions that seek to address cross-sector cultural/compliance problems in financial services. For example,

⁸⁰ ASIC Report 594, ‘Review of selected financial services groups’ compliance with the breach reporting obligation’ (September 2018).

ASIC's work in addressing cross-industry problems in relation to the design and sale of add-on insurance products through car dealers. In this way, an important role for regulators can be to generate solutions to industry-wide cultural/compliance issues that are difficult for individual firms to address and/or where action against individual firms may not generate timely cross-industry improvements.

195. Looking at ways to hold key individuals within entities to account for compliance/cultural failings can be important. On this point, ASIC supports the Enforcement Review Taskforce's recommendation that ASIC be adequately empowered to ban offending individuals in senior positions of control and influence from continued involvement in the financial sector, including banning individuals from managing financial services businesses. ASIC also supports the extension of the Banking Executive Accountability Regime to cover conduct.
196. ASIC supports the Taskforce's recommendation that the criteria for enlivening the banning power be broadened to include circumstances where an individual is unfit or improper for their role. ASIC considers that this is likely to result in increased manager accountability and should improve corporate culture in financial services entities.

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? (Q 39)

197. In addition to the recommendations made in the review, s 12DB of the ASIC Act should be extended to cover a broader range of false or misleading statements in the provision of financial services. In the context of insurance, ASIC would support consideration of a specific extension to insurance claims handling, settlement and disputes.

Dated: 25 October 2018

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