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Submissions in respect of policy issues arising from Round 6

Berrill & Watson Lawyers is a consumer financial services law firm. We act for everyday consumers in disputes in respect of Life and Disability Insurance, Financial Advice Disputes and General Insurance Disputes. We have limited our submission to only a few of the questions posed by the Royal Commission.

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

There are substantial consumer protections which exist in respect of financial services and which have performed well to protect consumers from detriment. For example, the Future of Financial Advice (FOFA) provided, for the first time, a statutory obligation on a financial adviser to act in the best interests of their client. Further, the FOFA reforms banned conflicted remuneration and also required greater transparency in respect of the disclosure of fees which consumers had to pay.

Whilst there has been a number of significant consumer protection measures introduced since the Global Financial Crisis in relation to financial services, there has been little which has been done to provide protections to consumers in relation to insurance. Indeed, the most significant amendments made in recent years to the Insurance Contracts Act expanded the rights of insurers.[1]

The Royal Commission's hearings have shown that consumers have suffered detriment due to:

1. Unfair Contract Terms (ie Heart Attack and other medical definitions);
2. Poor claims handling practices (see the case studies of TAL Life, Youi and Suncorp); and
3. Inappropriate sales practices (see Clearview case study).

Whilst the duty of utmost good faith[2] exists and could arguably apply in respect to each of the examples provided above, it is clear from the conduct exposed at the Royal Commission that consumers have not enjoyed the protections which they ought to.

It is our view that s.15 Insurance Contracts Act should be amended to afford consumers the same protection that they currently enjoy in respect of other financial services, including the consumer protections that are provided by the Australian Consumer Law.

[1] See for example the amendment to s.29(3) Insurance Contracts Act;

[2] S.13 Insurance Contracts Act;

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

5. Is the Standard Cover regime in Division 1 of Part V of the Insurance Contracts Act achieving its purpose? If not, why not, and how should it be changed?

Insurance is, and in our view needs to be, a diverse market place. That is, not all consumers can afford to pay for a financial advisor to guide them in their insurance decision making and not all consumers can afford to pay for a stand-alone retail life insurance policy. So, there needs to be some more affordable options available to those consumers who want or need insurance cover, at a lower price point. Those lower price points can include insurance purchased at bulk rates, such as Group Life Insurance or may also include insurance policies which are harder to claim upon, but which are priced accordingly.

In recent years we have seen examples of insurance policies which have been referred to as 'junk insurance'. That is, insurance which is in all reasonable likelihood unclaimable. Such products should not be able to be sold. However, insurers should be entitled to offer insurance products which have a high threshold for claiming, so long as the product is not mis-sold, does not operate in an unfair way, and so long as the policy is priced appropriately.

Many add-on insurance policies sold through car yards, accidental injury policies and funeral insurance policies have been shown to represent poor value for money to consumers. Indeed, the Royal Commission's hearings have led to a number of financial services providers introducing remediation schemes in respect of Consumer Credit Insurance.

The best way of understanding the value that an insurance product presents to policy holders/consumers is by reference to the 'loss ratio' of the insurance product. Each of the insurance policies referred to in the immediately preceding paragraph above are examples of insurance products with a low loss ratio.

The loss ratio in simple terms is the amount of money paid in claims (and expenses), as a percentage of premiums taken. So, an insurance product operating with a loss ratio of 20% is representing very poor value for consumers because only 20% of premiums taken is being returned to policy holders in claims paid. Conversely, an insurance product operating with an 80% loss ratio is providing very good value to consumers.

It is our view that the problem of 'junk insurance' could be substantially solved by making the following changes:

1. Extending Standard Cover provisions of the Insurance Contracts Act to include Life insurance contracts; and

2. Mandating the reporting of loss ratios to APRA on an annual basis and providing ASIC with product intervention powers in circumstances where the product presents poor consumer value.

Standard Cover

Part V of the Insurance Contracts Act provides minimum standards in respect of 'prescribed contracts'[3]. Prescribed contracts under the regulations include General Insurance products such as home and contents insurance policies and motor vehicle insurance policies, but does not include life insurance products.

A prescribed contract is required to provide basic levels of cover, unless a consumer has been 'clearly informed' of the fact that the insurance cover provided has derogated from the minimum standards provided.

If the Standard Cover provisions of the Insurance Contracts Act were extended to Life Insurance Contracts, consumers could have confidence that the life insurance cover provided met a minimum standard. However, one issue which we believe needs to be addressed in respect of Standard Cover provisions is the definition of "clearly informed the insured in writing" under s.35(2) of the Insurance Contracts Act. 'Clearly informed the insured' in writing has been interpreted to be satisfied if the insurer has merely sent a copy of the Product Disclosure Statement (PDS) or insurance policy to the policy holder.[4]

It is widely accepted that whilst it is advisable, it is rarely the case that a consumer would read a PDS or insurance policy that can sometimes be 100 pages long, or more, before purchasing the product. It is our view that the words "clearly informed" in s.35(2) must be given greater emphasis and should be such that where an insurer wishes to deviate from a prescribed minimum standard, there must be a clear notice that is prominent to a consumer that the insurance policy does not meet the minimum standard. This could be achieved by way of a Key Facts Sheet such as has been mandated with notification of flood cover under a home and contents insurance policy.[5]

Mandatory Loss Ratio Reporting

As we wrote above, a critical aspect of assessing whether an insurance product presents reasonable value to consumers is by reference to the loss ratio of the insurance product. It is submitted that there should be annual mandatory reporting of loss ratios to APRA in respect of all insurance products. Where a product is declared to have had a poor loss ratio, for example below 50%, the product issuer should be required to provide an explanation for the performance of the product. If the explanation provided is unsatisfactory ASIC should be able to exercise a product intervention power to either remove the product from the market or to make changes to the product in consultation with the product issuer to ASIC's and APRA's satisfaction.

Additionally, insurers should be required to publish their loss ratio on their website so that consumers can objectively compare insurance products.

It is our view that applying Standard Cover provisions to Life Insurance contracts, coupled with the monitoring and mandatory reporting of loss ratios on insurance products would provide significant benefit to consumers, whilst allowing insurers to provide diverse insurance products to the market at a range of price points which properly reflect the risk insured.

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[3] Reg 5 Insurance Contracts Regulations

[4] *Max Hams and 1 Ors v CGU Limited [2002] NSWSC 273 at 241-243*; see also *Marsh v CGU Insurance [2004] NTCA at 17*

[5] *Division 4 Insurance Contracts Regulations* 1985

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

23. Should Universal:
  23.1 Minimum coverage requirements; and/or
  23.2 Key definitions; and/or
  23.3 Key exclusions,

Be prescribed for group life insurance policies offered to MySuper members?

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

We believe that the use of standardised definitions in the General Insurance market has been beneficial for consumers and there would be further benefit for consumers in broadening the application for standardised definitions including in respect of life insurance contracts.

One good example of a product which should (and arguably does) have a standardised definition is TPD insurance held through a default MySuper superannuation fund. An insurance product such as this is widely held, and provides great benefit to consumers and the community alike. However, there was a period in or around 2012 in which the life insurance industry saw an increase in claim rates after which many of the insurers and superannuation funds began amending the definition of Total and Permanent Disability (TPD) to make it harder to claim upon. Regrettably, there are some instances where the changes made have gone too far.

For example, the current group life insurance policy through [redacted] requires that a claimant be under "ongoing care" which is relevantly defined as follows:

> *"a. Is under the regular and ongoing care of a medical practitioner who has given a clear prognosis that the Injury or Illness will continue throughout the life of the Covered Person (including after the expiry of the cover and the commencement of retirement) without any prospect of an improvement which would lead to a return to work (whether or not for reward) in any capacity; and*
> *b. Is complying with reasonable medical advice and treatment; and*
> *c. Has, in our opinion reached the maximum level of medical improvement possible for that Covered Person based on their Injury or Illness."*

The definition above, (particularly clause a) is an extreme departure from what would readily be accepted as the normal definition of total and permanent disability.[6] The requirement that a person have a prognosis that their medical condition will not improve, even after retirement age, is not consistent with the overarching intent of TPD insurance which is to supplement the retirement savings for people whose working lives have been cut short due to illness or injury.

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[6] Reg 1.03C Superannuation Industry (Supervision) Regulations 1994.

As a MySuper superannuation insurance product is a default product, it should follow that consumers receive the same basic default safety net. Consumers who would like to obtain different insurance cover (ie not default) can and should be entitled to seek out alternate definitions in a diverse insurance market to suit their needs.

At present, s.68AA(1) *Superannuation Industry (Supervision) Act* 1993 requires a MySuper trustee to provide an insured permanent incapacity benefit. For the purposes of s.68AA, a permanent incapacity benefit is a benefit provided to a member of a regulated superannuation fund *if, and only if* the member is suffering permanent incapacity[7] (our emphasis). Accordingly, if a permanent incapacity benefit is payable to a member based on a definition other than the definition prescribed, it is not a permanent incapacity benefit under s.68AA and the Trustee has not fulfilled its duty.

Despite the requirements contained within s.68AA *Superannuation Industry (Supervision) Act* 1993 it is very common for insurance policies to deviate from the definition of permanent incapacity prescribed by Reg 1.03C *Superannuation Industry (Supervision) Regulations* 1994. For example, a number of prominent superannuation funds have included a “retraining clause” into the definition of TPD. That is, the member would need to satisfy the insurer that they are unable to perform the work that they are or may become reasonably trained or qualified for given their education, training and experience (our emphasis).

It is unclear to us how or why such policies have been approved as MySuper products because on the face of it, such policies do not confirm with the obligations of a MySuper trustee.

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

All superannuation trustees are required to formulate, review and give effect to an insurance strategy.[8] Such a strategy is required to consider the kinds of insurance and the levels of insurance, and is to record the basis for the decisions that are made[9]. Importantly, in addition to the obligations referred to above, a trustee is only permitted to offer insurance cover of a particular kind (or level) if the cost of the insurance does not inappropriately erode the retirement income of beneficiaries.[10]

The requirement under s.52(7) of the *Superannuation Industry (Supervision) Act* 1993, requires a trustee to undertake a qualitative and quantitative assessment of the standard of the insurance cover which is provided to the members. It is our view that some trustees have obtained insurance arrangements which regrettably are not good value or which may be inappropriate for their member base. That is not because the obligations do not exist, rather it is in our view because the decision making of trustees in this area may not have been adequately scrutinised.

[7] S.68AA(10) Superannuation Industry (Supervision) Act 1993.
[8] S.52(7)(a) Superannuation Industry (Supervision) Act 1993.
[9] S.52(7)(a)(i) to (iv) Superannuation Industry (Supervision) Act 1993
[10] S.52(7)(c) Superannuation Industry (Supervision) Act 1993