Banking Royal Commission – Policy Questions arising from the Insurance Round

Submission by Legal Aid Queensland

Legal Aid QUEENSLAND

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Introduction

Legal Aid Queensland (LAQ) welcomes the opportunity to respond to the policy questions arising out of the Insurance Round of the Banking Royal Commission. LAQ provides input into State and Commonwealth policy development and law reform processes to advance its organisational objectives. Under the *Legal Aid Queensland Act 1997*, LAQ is established for the purpose of "giving legal assistance to financially disadvantaged persons in the most effective, efficient and economical way" and is required to give this "legal assistance at a reasonable cost to the community and on an equitable basis throughout the State". Consistent with these statutory objects, LAQ contributes to government policy processes about proposals that will impact on the cost-effectiveness of LAQ's services, either directly or consequentially through impacts on the efficient functioning of the justice system.

LAQ always seeks to offer policy input that is constructive and is based on the extensive experience of LAQ's lawyers in the day to day application of the law in courts and tribunals. We believe that this experience provides LAQ with valuable knowledge and insights into the operation of the justice system that can contribute to government policy development. LAQ also endeavours to offer policy options that may enable government to pursue policy objectives in the most effective and efficient way.

LAQ's Consumer Protection Unit lawyers and First Advice Contact team lawyers have extensive experience providing specialist advice and representation to clients in vulnerable circumstances with insurance issues. The unit provides advice to clients as well as lawyers and financial counsellors throughout Queensland in relation to insurance issues, consumer law issues, mortgage stress, housing repossession, debt, contracts, loans, telecommunications and unsolicited consumer agreements.

LAQ regularly assists and represents clients:

(a) who have home and contents insurance issues following natural disasters in Queensland;

(b) with insurance issues following motor vehicle accidents; and

(c) experiencing problems with add-on insurance products that they were unaware that they had purchased.

This submission is informed by that knowledge and experience. LAQ has only responded to the questions that it has direct experience of.

POLICY QUESTIONS ARISING FROM MODULE 6

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?**

In LAQ's submission the current regulatory regime is not adequate to minimise consumer detriment.

The following changes should be made to the current regulatory regime:

(a) The Unfair Contract Terms Regime (UCT) set out in the Australian Consumer Law and ASIC Act should be extended to apply to the General Insurance and Life Insurance industries.
(b) There should be a prohibition on the unsolicited selling of financial products.
(c) Product Intervention Powers should be introduced to provide ASIC and other appropriate regulators with power to intervene to:
    (i) Prevent products that cause consumer detriment or provide no benefit to consumers from being sold.
    (ii) Remove from sale products that are currently being sold in the market before they cause additional harm and detriment to consumers.
(d) Design and Distribution obligations should be imposed on financial firms and insurers that would require them to consider and identify the benefit a product would provide to consumers before the product is offered for sale.
(e) The General Insurance Code of Practice (GI Code) should be strengthened to provide the Code Compliance Committee with the power to impose stronger sanctions on an insurer for breaches of the Code. Currently, the sanctions the Code Compliance Committee is able to impose on general insurers for a breach of the GI Code do not provide a strong enough incentive to insurers to ensure compliance with the Code.
(f) The Life Insurance Code of Practice (LI Code) should be strengthened to provide the Code Compliance Committee with the power to impose stronger sanctions on an insurer for breaches of the Code. Currently, the sanctions the Code Compliance Committee is able to impose on Life insurers for a breach of the LI Code do not provide a strong enough incentive to insurers to ensure compliance with the Code.
(g) Both Codes should have a co-regulatory model because it is extremely difficult for the peak bodies to be both a regulator of conduct and a peak body.

A. PRODUCT DESIGN

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

Consumers buy insurance products in the belief that the product will protect them against harm. LAQ supports the view that there are products, such as accidental death and accidental injury insurance that provide illusory, unnecessary or worthless cover to consumers. These products should not be sold.

3. 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?

LAQ supports the requirements of the LI Code requiring medical definitions to be updated for on-sale products being extended to all products. The evidence from the Royal Commission has shown that not updating these definitions has caused consumers significant harm and distress.

B. DISCLOSURE

4. Is the current disclosure regime for financial products set out in Chapter 7 of the *Corporations Act 2001* (Cth) and Division 4 of Part IV of the *Insurance Contracts Act 1984* (Cth) adequately serving the

interests of consumers? If not, why not, and how should it be changed? In answering these questions, address the following matters:

4.1 the purpose(s) that the product disclosure regime should serve;
4.2 whether the current regime meets that purpose or those purposes; and
4.3 how financial services entities could disclose information about financial products in a way that better serves the interests of consumers.
(Despite the reference to the *Insurance Contracts Act 1984* (Cth), this question is not limited in scope to contracts of insurance.)

LAQ supports the obligation in the Corporations Act and the Insurance Contracts Act (ICA) that requires companies to provide disclosure to consumers about the products they are purchasing. An effective disclosure should include:

(a) What is covered by the policy?
(b) What is not covered by the policy?
(c) Any monetary or time limits that affect the extent of the coverage.
(d) A list of the relevant features that allows consumers to easily compare their product and its features against all other products.

In LAQ's experience in dealing with consumers following natural disasters the current disclosure regime is not achieving these aims.

LAQ has seen people who:

(a) Believe their policy provides comprehensive cover when the policy has significant exclusions.
(b) Have not read their Product Disclosure Statement (PDS) and as a result are unaware of the extent of their coverage.
(c) Have switched to cheaper cover believing it provides the same coverage as their original policy when it provides a lesser coverage.
(d) Do not understand the policy they have taken out.

Improving consumer understanding of insurance products has not been achieved by providing consumers with lengthy PDS documents. In LAQ's view consumer understanding has been somewhat improved by the use of key factsheets. However, there is still significant work to be done in improving consumer understanding even after the introduction of Key Fact Sheets.

In LAQ's submission it is important that the government and insurers continue to look at methods of disclosure that are alternatives to a 60 page PDS document that many consumers do not understand. Any new methods of disclosure should consider:

(a) Alternatives to written disclosure.
(b) Where written disclosure is used, the use of plain English to improve understanding of the coverage being purchased.
(c) Continued development of simplified disclosure such as the key fact sheets that have been recently introduced.

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

In LAQ's submission the purpose of the standard cover regime was to:

(a) protect consumers by providing them with a base level of insurance coverage.
(b) clearly inform consumers about any variations from the standard cover.

The problem is that over time, insurers have decided to meet their obligations to clearly inform consumers of variation to standard cover by providing a lengthy PDS document which sets out the exclusions from standard cover.

In LAQ's experience the intent of the standard cover regime to provide consumers with a base level of cover and inform them of any deviations from that cover has not been met because:

(a) Consumers are overwhelmed by long PDS documents and do not read them.
(b) Consumers who do attempt to read the PDS find it difficult to understand.
(c) Different insurance products that purport to protect against the same risk contain nuanced differences in coverage that can only be identified through a forensic comparison of the different PDS documents.
(d) Exclusions from the base level of cover means that many consumers do not have the standard level of insurance cover that was originally envisaged by the legislation.

How should Standard cover be changed?

1. Standard cover should mean a base level of insurance cover that protects consumers against risk. This cover cannot be deviated from by an insurer.
2. If Insurers want to differentiate their products they are able to do this by adding additional features to the base level of cover.

This approach would provide consumers with some certainty that when they purchase insurance they will be protected against standard risks that the community reasonably expects an insurance policy would protect them against.

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

Following the 2011 floods in Queensland, it was apparent that the variety of definitions used in different insurance policies to define flood caused consumers significant detriment because:

(a) Consumers' understanding of the definition of flood was different to the definition contained in their policy.
(b) Different insurance policies that purported to cover flood, differed widely in the scope of coverage because of the different definitions of flood.
(c) Consumers were confused and felt misled about the extent of their coverage.

These problems were addressed by the introduction of a standard definition of flood which allowed consumers to be certain about the level of cover they had and allowed them to more easily compare policies.

Informed by this experience, in LAQ's submission having more standardised terms in insurance policies means:

(a) Consumer confusion about the extent of their coverage is reduced;
(b) Comparing the scope of coverage provided by different insurance policies is easier for consumers.

In LAQ's view, there are other terms that would benefit from standard definitions and applications in insurance policies. One term that LAQ would highlight is the use of terms that deal with reasonable maintenance and upkeep of a property. The use of these terms has caused consumers significant confusion following cyclones in North Queensland, which would be reduced by a standardised definition.

C. SALES

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

LAQ does not support the exemption from the ban on conflicted remuneration for general insurance products being retained.

In LAQ's submission, the evidence from the Royal Commission shows the exemption has led to salespeople acting in ways that are not in the consumer interest and consumers being placed into policies that provide them with little or no benefit.

Instead, the salespeople pursue their own interests by pursing the commission payable for selling the products. This is an inherent conflict of interest that has led to poor consumer outcomes. Also, the industry has been unable to provide any valid reason showing why the exemption should be retained given the poor industry behaviour that has occurred under the exemption.

8. 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?

LAQ does not support the exemption from the ban on conflicted remuneration for life insurance products being retained.

In LAQ's submission, the evidence from the Royal Commission shows the exemption has led to salespeople acting in ways that are not in the consumer interest and consumers being placed into policies that provide them with little or no benefit.

Instead, the salespeople pursue their own interests by pursing the commission payable for selling the products. This is an inherent conflict of interest that has led to poor consumer outcomes. Also, the industry has been unable to provide any valid reason showing why the exemption should be retained given the poor industry behaviour that has occurred under the exemption.

LAQ supports the cap on these benefits being reduced to zero.

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

LAQ supports the banning of conflicted remuneration as a way of ensuring that sales representatives do not use inappropriate sales practices.

In LAQ's submission limits should also be placed on how sales targets are used in the assessment of an employee's work performance. If meeting sales targets are weighted too heavily in the assessment of an employee's performance, it risks the employee prioritising sales over whether the product is appropriate for the consumers.

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

LAQ supports a ban on the direct sale of insurance via outbound telephone calls. The evidence from the Royal Commission and LAQ's experience in dealing with clients has shown that outbound telephone calls have caused significant consumer detriment. This detriment has been caused by:

(a) The pressure placed on consumers through inappropriate and misleading practices during the telephone calls;
(b) The products having little or not value;
(c) Misrepresentations made about the quality and necessity of the product during the sales process.

This harm caused to consumers can only be fixed by banning the sale of insurance through outbound telephone calls.

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

LAQ supports Recommendation 10.2 from the Productivity Commission's report which will address some of the harm caused by the sale of inappropriate product that is caused by a reliance on the use of a general advice model in the sale of financial products.

12. 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?

LAQ supports the proposal that would require all financial services entities that maintain an approved product list being required to comply with the obligations in FSC Standard No 24.

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

LAQ supports the view that the sale of add-on insurance products by motor dealers should be banned.

LAQ's experience in assisting vulnerable consumers who have been sold inappropriate add-on insurance products, the evidence heard by the Royal Commission and the practices revealed by ASIC over the past 18 months has shown that the sale of add-on insurance by Motor Dealers is characterised by:

(a) Conflicted remuneration. The payment of very high commission to motor dealers for the sale of add-on insurance products has resulted in them focusing on selling the products at any cost rather than examining whether the products provide any benefits to consumers.
(b) The sale of inappropriate products to consumers that have little or no value.
(c) Motor dealers acting in their own interest and not considering the consumer interest.
(d) Misleading behaviour by motor dealers to consumers about the value and benefits of add on insurance products.
(e) The products are more expensive than similar products that are bought outside the motor dealer's sales process.

In LAQ's submission these problems can only be fixed by a ban on the sale of these products by motor dealers.

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

If the sale of add-on insurance products by motor dealers is not banned, a deferred sales model should be introduced.

The deferred sales model should:

(a) Introduce a 5 day period that must elapse before an add-on insurance product can be sold.
(b) Insurers should be required to train and monitor the actions of their authorised representatives who sell add-on insurance products.

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

LAQ does not support the use of a deferred sales model for any other insurance products.

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

LAQ supports a prohibition on the payment for commissions for the sale of add on insurance products if the ban on conflicted remuneration is not extended to general insurance products.

In the alternative, if the payment of commissions is not banned then commissions should be capped at a maximum of 5% of the value of the products sold.

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

LAQ supports the proposal that the obligations in s912A of the Corporations Act should apply to all aspects of the provision of insurance claims.

In particular while helping consumers in vulnerable circumstances with the settlement of insurance claims following natural disasters, LAQ has witnessed problems with claims handling including:
(a) The inappropriate use of cash settlements;
(b) Claims taking too long to be approved;
(c) Approved claims taking too long to have the property fixed; and
(d) Expert reports produced for insurers that have the appearance of being conflicted.

The effect of these problems on consumers is likely to be alleviated by the applications of s912A to claims handling and settlement.

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

LAQ does not support ASIC having jurisdiction over the handling and settlement of individual insurance claims. In LAQ's submission it is appropriate that this jurisdiction remains with the Australian Financial Complaints Authority (AFCA). Instead ASIC does have a role in dealing with and where appropriate prosecuting insurance companies for systemic failures in claims handling and settlement.

General insurance
22. Should the General Insurance Code of Practice be amended to provide that, when making a decision to cash settle a claim, insurers must:
22.1 act fairly; and
22.2 ensure that the policyholder is indemnified against the loss insured (as, for example, by being able to complete all necessary repairs)?

LAQ supports the proposed amendment to the GICOP to address the problems that consumers have experienced due to the inappropriate use of cash settlements.

In LAQ's submission the following additional requirements should also be included:

(a) An ability for consumers to go back to an insurer if the cash settlement money has been spent exclusively on repairs and runs out before the repairs are completed;
(b) An ability to access AFCA's Fast Track process if there is a dispute about whether further payments under the Cash Settlement process should be required following a request under (a); and
(c) A prohibition on the use of Cash Settlements where the consumer has a mortgage and the payment will be made to the mortgagee and not the consumer.

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

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

In LAQ's submission there is no reason why unfair contract terms should not apply to insurance contracts in the manner proposed by the government in the Extending Unfair Contract Terms Protection to Insurance Contracts paper published in June 2018.

LAQ strongly supports the proposals set out in the paper.

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

In LAQ's submission, under the current law the duty of utmost good faith does not apply to the way that an insurer interacts with an external dispute resolution (EDR) body. LAQ does not support the application of section 13 to the way insurers interact with an EDR body.

In LAQ's experience consumers find it very difficult to successfully apply the principles of utmost good faith to protect themselves against what they feel is inappropriate or unfair conduct being engaged in by insurers. This view is supported by the very few cases decided by the Financial Ombudsman Service (FOS) and the Courts where the principles of utmost good faith have been applied in the consumer's favour. Instead LAQ supports the proposed change set out in Question 17 as being more effective for improving how consumers will interact with EDR bodies.

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

LAQ is not able to comment on this 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)?

LAQ agrees that it is important that an insured is honest with insurers and has a duty to disclose relevant information about themselves and their circumstances. However, in LAQ's experience, the duty, as it is currently written in section 21 of the ICA, places too greater burden on consumers to remember details about every aspect of their lives. The duty has seen instances where claims are denied by insurers using section 21, where the consumer has not deliberately misled the insurer about their circumstances.

As a result in LAQ's submission, the purpose of section 21 would be more appropriately served by the insured having a duty to take reasonable care not to make a misrepresentation to an insurer, similar to the

duty set out in section 2 of the *Consumer Insurance (Disclosure and Representations) Act 2012* (UK). This approach would provide a better balance between the rights of consumers and the rights of insurers.

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

LAQ supports the proposal that the LICOP and GICOP should apply to all insurers in respect of the relevant categories of business.

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

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

LAQ supports there being greater consequences for insurers for a breach of the LICOP and GICOP. Currently, the sanctions for a breach of either code do not provide insurers with sufficient incentive to correct behaviour that does not meet the standards set out in the Code.

LAQ supports a breach of the LICOP and GICOP constituting a failure to comply with financial services laws under section 912A of the Corporations Act.

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

In LAQ's submission the purposes of an infringement notices are:
(a) To highlight and punish wrongful conduct; and
(b) To prompt corrective action by a company of the inappropriate behaviour.

On the evidence produced by the Royal Commission, it appears that infringement notices are not achieving the aim of ensuring that financial services entities correct their behaviour.

As a consequence, to give greater effect to the purposes of an infringement notice, LAQ supports:
(a) Increasing the applicable number of penalty units to increase the punishment and deterrent effects of the infringement notice; and
(b) Introducing tiered infringement notices to allow regulators to better differentiate between different levels of wrongful conduct by financial services entities.

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

The evidence of the Royal Commission has shown that there are many financial services entities that do not have adequate compliance systems, including oversight of compliance system.

LAQ supports ASIC and APRA having a greater role in ensuring that financial services entities have adequate compliance systems. This role should involve an annual audit of all financial services entities compliance systems.

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

37.1 preventing breaches of financial services laws and other regulatory obligations; and
37.2 ensuring that any breaches that do occur are remedied in a timely fashion?

LAQ supports the view that there should be greater consequences for financial services entities that do not have effective compliance systems. In LAQ's view these greater consequences are best achieved by larger penalties for breaches of the law and a regulator (ASIC) with the appropriate powers and resources that would allow them to prosecute breaches of financial services law.

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

In LAQ's submission, financial services regulators and financial services law does not have a direct role in shaping the culture of financial services entities. This is an internal matter for the entity.

However, regulators have a role in deterring behaviour resulting from a culture that does not sufficiently value compliance and negatively affects consumers. For this role to be effective, the laws must give regulators power to impose sanctions that are appropriate for conduct and sufficient to act as an incentive for change.

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

LAQ supports the recommendations set out in the ASIC Enforcement Review Taskforce Report.