

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

Rubric 6-68 – Add-On Insurance

IAG'S WRITTEN SUBMISSIONS

A. INTRODUCTION

1. These submissions respond to the submissions of counsel assisting on Friday 21 September 2018 that Swann Insurance (Aust) Pty Ltd (**Swann**) may have engaged in:
 - (a) misconduct because of three possible breaches of s 912A of the *Corporations Act* 2001 (Cth) as well as a possible breach of section 145 of the *National Credit Code*;¹
 - (b) conduct that fell below community standards and expectations in various ways.²
2. Insurance Australia Group, which comprises Insurance Australia Group Limited and its related bodies corporate (including Swann) (**IAG**), denies that there has been misconduct by Swann but accepts that Swann's conduct may have fallen below community standards and expectations in the ways and for the reasons set out below.
3. By way of introduction, while Swann was a subsidiary of Insurance Australia Group Limited, Swann was effectively a standalone business that had its own Australian financial services licence, its own management structures and its own legal and risk and compliance structures.³ From 1 January 2008 until late 2014, Swann reported in to CGU Insurance Limited (**CGU**) and operated under a devolved business model.⁴ Between late 2014 and late 2015, Swann reported in to the Commercial Insurance Division of CGU and continued to operate as a devolved business.⁵ Between late 2015 and August 2016, Swann formed part of IAG's Australian Business Division.⁶
4. In August 2016, Swann exited the motor dealer channel with the sale of its distribution rights to Eric Insurance Limited.⁷ In October 2017, Swann also wound down its motorcycle dealer distribution business.⁸ It no longer sells any form of add-on insurance.

¹ T 6503:40-6504:18.

² T 6504:18-34.

³ T 6137:35-39.

⁴ Witness Statement of Benjamin Bessell dated 27 August 2018 at [15].

⁵ Witness Statement of Benjamin Bessell dated 27 August 2018 at [15].

⁶ Witness Statement of Benjamin Bessell dated 27 August 2018 at [15].

⁷ Witness Statement of Benjamin Bessell dated 27 August 2018 at [12(a)].

⁸ Witness Statement of Benjamin Bessell dated 27 August 2018 at [12(a)].

5. These written submissions address:
 - (a) the four possible instances of misconduct identified by counsel assisting;
 - (b) the conduct possibly falling below community standards and expectations; and
 - (c) the causes of the conduct referred to in (b).

B. POSSIBLE INSTANCES OF MISCONDUCT BY SWANN

B1. Possible breach of s 912A(1)(a)

6. Counsel assisting submitted that there may have been a possible instance of misconduct as follows:

On the evidence, it is open to the Commissioner to find that Swann may have engaged in misconduct in the following ways: first, in circumstances where Swann undertook no meaningful review of its products to determine whether they provided any value to customers, continued to authorise the sale of those products after becoming aware that ASIC held concerns about their product design and sales practices, established and maintained arrangements that incentivised dealers to sell as many add-on products to consumers as possible regardless of the suitability or value to consumers, and failed to establish systems to oversee and monitor the sales practices of its authorised representatives.

Swann may have breached 912A(1a) of the Corporations Act by failing to do all things necessary to ensure that the financial services covered by its licence were provided efficiently, honestly and fairly.

7. In short, counsel assisting has submitted that in the four circumstances identified in the first paragraph of the above quote Swann may have failed to do all things necessary to ensure that financial services were provided by it “efficiently, honestly and fairly”. Those four circumstances are considered further below. First it will be helpful to examine the meaning of the words “efficiently, honestly and fairly” in s 912A(1)(a).
8. In *Australian Securities and Investments Commission v Camelot Derivatives Pty Ltd (in liq)*⁹ (references omitted) it was held that:
 - (a) the words “efficiently, honestly and fairly” must be read as a compendious indication meaning a person who goes about their duties efficiently having regard to the dictates of honesty and fairness, honestly having regard to the dictates of efficiency and fairness, and fairly having regard to the dictates of efficiency and honesty;
 - (b) the words “efficiently, honestly and fairly” connote a requirement of competence in providing advice and in complying with relevant statutory obligations. They also connote an element not just of even handedness in dealing with clients but a less readily defined concept of sound ethical values and judgment in matters relevant to a client’s affairs;

⁹ (2012) 88 ACSR 206 at [69] cited recently without references in *ASIC v Westpac (No. 2)* (2018) 357 ALR 240 at [2347] per Beach J; see also *ASIC v Avestra Asset Management Ltd (in liq)* (2017) 348 ALR 525 at [191] per Beach J; see also *ASIC v Cassimatis (No. 8)* (2016) 336 ALR 209 at [674] per Edelman J.

- (c) the word “efficient” refers to a person who performs his duties efficiently, meaning the person is adequate in performance, produces the desired effect, is capable, competent and adequate. Inefficiency may be established by demonstrating that the performance of a licensee’s functions falls short of the reasonable standard of performance that the public is entitled to expect;
 - (d) it is not necessary to establish dishonesty in the criminal sense. The word “honesty” may comprehend conduct which is not criminal but which is morally wrong in the commercial sense; and
 - (e) the word “honestly” when used in conjunction with the word “fairly” tends to give the flavour of a person who not only is not dishonest, but also a person who is ethically sound.
9. ASIC’s Regulatory Guidelines do not materially illuminate the precise content of the words “efficiently, honestly and fairly” in s 912A(1)(a), stating that it is not possible to give prescriptive guidance on what is required under s 912A(1).¹⁰
 10. Turning to the four matters identified by counsel assisting, *first*, counsel assisting submitted that Swann undertook no meaningful review of its products to determine whether they provided any value to customers. However, in fact a number of reviews of this kind were carried out by Swann. For example, following ASIC’s letter of 15 July 2016, Swann undertook a detailed review of its active Loan Protection Insurance policies which include involuntary unemployment cover.¹¹ Similarly, in August 2016 Swann also carried out a review of its Gap insurance portfolio.¹²
 11. Further, and in any event, given that there is no positive obligation under the *Corporations Act* to carry out such reviews, even if Swann had not carried out reviews of this kind that fact, of itself, and without more, would not give rise to a breach of s 912A(1)(a). Something more would be required. That additional matter is not identified in counsel assisting’s submissions.
 12. *Secondly*, counsel assisting submitted that Swann continued to sell add-on insurance products after becoming aware that ASIC held concerns about their product design and sales practices. Swann accepts that it continued to sell these products after concerns were first raised by ASIC in September 2015¹³ but at the time Swann was seeking through the Insurance Council of Australia to take an industry approach to address the identified problems with add on insurance.¹⁴ While with the benefit of hindsight, reasonable minds could differ as to what approach Swann could or should have taken in and after September 2015, it is difficult to see that becoming involved in an industry wide solution through the Insurance Council of Australia was inefficient or unfair (let alone dishonest) such as to fall short of what is required by s 912A(1)(a).
 13. It is also important to remember that reasonably soon after September 2015, Swann entered into negotiations with Eric Insurance Limited to enable Swann to exit the motor vehicle channel; which led to the sale of its distribution rights in August 2016.¹⁵

¹⁰ ASIC RG Licensing: Meeting the General Obligations RG104.7.

¹¹ Witness Statement of Benjamin Bessell dated 27 August 2018, Exhibit BB-167.

¹² Witness Statement of Benjamin Bessell dated 27 August 2018, Exhibit BB-170.

¹³ T 6128:7-8.

¹⁴ T 6126:30-36.

¹⁵ Witness Statement of Benjamin Bessell dated 27 August 2018 at [12(a)].

14. Further, Swann implemented a number of changes to its product design, pricing and procedures to enhance their value to customers as detailed below:
- (a) Swann improved the cover provided under its Gap Insurance product, so that a benefit of \$2,000 would still be payable if the corresponding loan contract was paid out, discharged, refinanced or terminated before a claim was made.¹⁶ This change was effective from 1 December 2015.
 - (b) Swann reviewed its claim procedures to ensure that all policies in respect of which there was a life claim would result in contact being made with the deceased estate to determine whether other policies in the deceased's name were also to be cancelled.¹⁷
 - (c) In response to concerns raised by ASIC in relation to differential pricing, Swann reduced the commission payable in respect of business-use consumer credit insurance products to 20%, in line with the commission payable for personal use products. Swann made a corresponding reduction in the premium payable in respect of business-use products so that the premium payable was in line with personal use products.¹⁸ These changes were effective as at 18 April 2016.
 - (d) In response to concerns raised by ASIC in relation to the involuntary unemployment cover provided under Swann's consumer credit insurance products, Swann:
 - (i) increased the maximum amount payable for involuntary unemployment from \$3,000 to \$10,000 for all active policies; and
 - (ii) increased the payment period for involuntary unemployment cover from 90 to 150 days.¹⁹
15. Further, on 1 June 2017, independent of the Resolution Program, Swann commenced an annual policyholder notification process to remind policyholders that they hold a multi-year policy(ies) with Swann, and that they can cancel the policy(ies) should they wish.²⁰
16. *Thirdly*, counsel assisting submitted that Swann established and maintained arrangements that incentivised dealers to sell as many add-on insurance products to consumers as possible regardless of their suitability or value to consumers. This submission appears to relate to the payment of commissions to Swann's authorised representatives. Again, Swann took the approach that the issue of commissions would need to be dealt with by way of industry reform.²¹ This approach appears objectively reasonable: if one insurer unilaterally reduced commissions, dealers would simply go to other insurers who had not. Ultimately the industry approach led to a commission capping submission to the ACCC on behalf of nine insurers including Swann and IAG, but that submission was rejected.²² Again, it is hard to see that

¹⁶ Witness Statement of Benjamin Bessell dated 27 August 2018, Exhibits BB-99 and BB-100.

¹⁷ Witness Statement of Benjamin Bessell dated 27 August 2018, Exhibit BB-100.

¹⁸ Witness Statement of Benjamin Bessell dated 27 August 2018, Exhibits BB-92 and BB-102.

¹⁹ Witness Statement of Benjamin Bessell dated 27 August 2018, Exhibit BB-167.

²⁰ Witness Statement of Benjamin Bessell dated 27 August 2018 at [48].

²¹ T 6126:40-6127:4.

²² T 6128:1-5.

taking this industry wide approach was inefficient or unfair (let alone dishonest) such as to fall short of what is required by s 912A(1)(a).

17. *Fourthly*, counsel assisting submitted that Swann failed to establish systems to oversee and monitor the sales practices of its authorised representatives. However, Swann did have such systems in place. From at least 1 January 2008, Swann had the following systems and processes in place to ensure that the motor vehicle and motor dealers complied with regulatory obligations:
- (a) conducting induction training for authorised representatives;
 - (b) conducting ongoing training for authorised representatives;
 - (c) recording training in electronic training platforms;
 - (d) conducting Electronic Compliance Questionnaire on a sample basis to assess dealer intermediaries' knowledge of, and compliance with, legislative requirements;
 - (e) maintaining the Activ8 front end sales system;
 - (f) reporting identified breaches of the Swann Compliance Mailbox to be recorded in the Swann breach register; and
 - (g) maintaining complaints and internal dispute resolution processes.²³

Induction training

18. Swann required every new authorised representative to undertake induction training using its online training tool.²⁴ This included compliance modules in relation to Tier 2 General Advice, Privacy Principles and the General Insurance Code of Practice.²⁵
19. Pursuant to the terms of the authorised representative agreements, authorised representatives agreed that they could not perform any of the 'Authorised Services' under the authorised representative agreements until they had successfully completed the relevant induction training.²⁶

Ongoing training

20. Authorised representatives were required to undertake re-certification training every three years in relation to compulsory compliance modules.²⁷
21. Pursuant to the terms of the authorised representative agreements, authorised representatives agreed that they would maintain a level of competency and expertise in relation to the provision of financial services, as reasonably required by Swann.²⁸

²³ Witness Statement of Benjamin Bessell dated 27 August 2018 at [17].

²⁴ Witness Statement of Benjamin Bessell dated 27 August 2018 at [18].

²⁵ Witness Statement of Benjamin Bessell dated 27 August 2018 at [20].

²⁶ Exhibit 6.306 at clause 5.10(e).

²⁷ Witness Statement of Benjamin Bessell dated 27 August 2018 at [26].

²⁸ Exhibit 6.306 at clause 5.10(b).

Electronic compliance questionnaires

22. Swann's primary method of monitoring authorised representatives' knowledge of regulatory requirements comprised an electronic survey conducted on a regular basis known as the electronic compliance questionnaire.²⁹
23. The Swann Risk and Compliance Manager was responsible for managing and overseeing the electronic compliance questionnaire. The survey questions were directed at assessing an authorised representative's compliance with regulatory requirements and financial services laws, particularly obligations under the *Corporations Act*.³⁰
24. The electronic compliance questionnaire content changed periodically to accommodate changes in regulatory requirements.³¹

Activ8

25. Activ8 was the Swann front-end sales system used by motor vehicle and motorcycle dealers and Swann's business development team.³² It supported dealer compliance by:
 - (a) drawing information from the Intermediary Profile Database to populate Financial Services Guides (**FSG**) to be issued by dealers to policyholders;
 - (b) containing current Product Disclosure Statements (**PDS**) to be issued by dealers to policyholders;
 - (c) automatically arranging for the dispatch of a PDS(s) and FSG when a dealer issued a new policy(ies) to a policyholder;
 - (d) containing links to Swann's Guidelines and relevant legislation; and
 - (e) ensuring that a dealer could only sell either a Gap product or a Purchase Price Protection product to a policyholder in any one transaction.³³
26. Activ8 also contained underwriting guidelines. At the point of sale, the dealer would enter policyholder information into Activ8. If the requested insurance policy fell outside the underwriting guidelines, Activ8 would prevent the dealer from proceeding to sell the relevant product.³⁴

B2. Possible breach of s 912A(1)(ca)

27. Counsel assisting submitted that there may have been a second possible instance of misconduct by Swann as follows:

Second, by failing to establish systems to oversee and monitor the sales practices of Swann's authorised representatives, Swann may have breached section 912A(1)(ca) of the Corporations Act by failing to take reasonable steps to ensure that its representatives complied with financial services law.

²⁹ Witness Statement of Benjamin Bessell dated 27 August 2018 at [29].

³⁰ Witness Statement of Benjamin Bessell dated 27 August 2018 at [30].

³¹ Witness Statement of Benjamin Bessell dated 27 August 2018 at [31].

³² Witness Statement of Benjamin Bessell dated 27 August 2018 at [32].

³³ Witness Statement of Benjamin Bessell dated 27 August 2018 at [32].

³⁴ Witness Statement of Benjamin Bessell dated 27 August 2018 at [33].

28. Swann did however have systems to oversee and monitor the sales practices of its authorised representatives. The starting point is that the agreements between Swann and its authorised representatives included the following terms:
- (a) the authorised representatives agreed to provide the authorised services honestly, fairly and efficiently and comply with all policies, procedures, guidelines and any reasonable requirement given by Swann in relation to the provision of services and compliance with applicable laws;
 - (b) the owner of the motor vehicle or motorcycle dealership (in the case of corporate representative agreements) was required to monitor and supervise any individuals sub-authorised as authorised representatives of Swann, and establish procedures and controls designed to facilitate and enforce compliance with the authorised representative agreement including compliance with applicable laws; and
 - (c) the authorised representative was required to inform Swann immediately of any complaint by, or a dispute with, a policyholder in relation to the provision of the authorised services.³⁵
29. In addition, as set out above in paragraphs 17 to 26 above, from at least 1 January 2008, Swann had a range of systems and processes in place to ensure that the motor vehicle and motorcycle dealers complied with regulatory obligations. This included induction training for authorised representatives, ongoing training, electronic compliance questionnaires and the Activ8 front-end sale system.³⁶ It has been held that the requirement in s 912A(1)(ca) combined with the requirements in s 912A(1)(f) of the *Corporations Act* (that representatives are adequately trained) suggests that the holder of an Australian financial services licence should undertake a continuous training program that is calculated to produce competent representatives or maintain their level of competence.³⁷ This is what Swann did with induction training, ongoing training, electronic compliance questionnaires and the Activ8 front-end sale system.

B3. Possible breach of s 912A(1)(aa)

30. Counsel assisting submitted that there may have been a third possible instance of misconduct by Swann as follows:

Third, by failing to have in place adequate arrangements for the management of any conflicts of interest that arose through incentivising sales of the add-on insurance products, Swann may have breached section 912(1)(aa) of the Corporations Act.

31. Swann had a number of processes to manage potential conflicts that arose through incentivising sales of add-on insurance products. First, it had the training program for authorised representatives³⁸ outlined in paragraphs 17 to 26 above. That program required that authorised dealers be trained before commencing selling any Swann insurance products. Dealers and their employees had to also complete an electronic

³⁵ Witness Statement of Benjamin Bessell at [16]; see also by way of example Exhibit 6.306.

³⁶ Witness Statement of Benjamin Bessell at [17]-[32].

³⁷ *Avoca Consultants Pty Ltd v Millenium3 Financial Services Pty Ltd* (2009) 179 FCR 46 at [344] per Barker J; see also *ASIC v Westpac* (2018) 357 ALR 240 at [2490] per Beach J.

³⁸ T 6104:24-26.

compliance questionnaire,³⁹ which would be sent to dealers on a regular basis that was overseen by the Swann Risk and Compliance Manager.⁴⁰ In addition, authorised representatives could log a conflict of interest in the Swann Compliance Mailbox.⁴¹

32. Section 912A(1)(aa) could not be construed as prohibiting in all circumstances the payment of any commissions. Indeed, s 145 of the *National Credit Code*, for example, contemplates that a commission may lawfully be paid. Counsel assisting does not identify the relevant conflict of interest nor how the arrangements which Swann had in place were said to be inadequate. On the evidence there is no basis for a finding that Swann engaged in this possible instance of misconduct.

B4. Possible breach of s 145 of the National Credit Code

33. Counsel assisting submitted that there may have been a fourth possible instance of misconduct by Swann as follows:

Fourth, Swann may have breached section 145 of the National Credit Code by authorising payments to 34 authorised representatives that may have exceeded the 20 per cent cap on commissions imposed on under that section.

34. In its letter to the Commission dated 29 June 2018, IAG notified the Commission that it had identified payments made by Swann to 34 of its authorised representatives, which may have exceeded the cap.⁴² The reason for the potential breach was that although on a transactional basis the personal use consumer credit insurance was capped at 20%, when an aggregate premium view was taken, some consumer credit insurance premium value may have been included in that overall number in respect of which a further commission was paid.⁴³
35. As set out in its letter, IAG's view is only that it may have breached the cap. The letter was sent out of abundant caution given the law is unclear as to what constitutes commission for the purposes of the *National Credit Code*. There is no basis on which the Commission could find on the present evidence that there has in fact been a breach of s 145 of the *National Credit Code*.

B5. Conclusion on possible misconduct

36. For the reasons set out above on the evidence before the Commission there is no basis on which the Commission would find that Swann has engaged in misconduct in any of the ways submitted to be open by counsel assisting.

C. POSSIBLE INSTANCES OF CONDUCT FALLING BELOW COMMUNITY STANDARDS AND EXPECTATIONS BY SWANN

37. Counsel assisting submitted that the first instance of conduct falling below community standards and expectations by Swann that the Commission was open to find was "*failing to take meaningful steps to ensure that its authorised representatives only sold add-on insurance products in circumstances where the product would be of value to the customer*".

³⁹ T 6104:35-37.

⁴⁰ T 6105:1-3.

⁴¹ T 6105:8-13.

⁴² Exhibit 6.3111.

⁴³ T 6112:4-16.

38. IAG accepts that on the evidence before the Commission it would be open to the Commission to find that Swann did engage in conduct falling below community standards and expectations by failing to ensure that its authorised representatives only sold add-on insurance products in circumstances where the product would be of value to the customer.
39. Counsel assisting submitted that the second instance of conduct falling below community standards and expectations by Swann that the Commission was open to find was “*designing and implementing remuneration and incentive systems that promoted conflicts of interest and unfair sales practices*”.
40. IAG accepts that on the evidence before the Commission it would be open to the Commission to find that Swann’s remuneration and incentive systems fostered an environment where conflicts of interest could arise and where unfair sales practices could occur and that conduct fell below community standards and expectations.
41. Counsel assisting submitted that the third instance of conduct falling below community standards and expectations by Swann that the Commission was open to find was “*failing to promote sales practices that focused on delivering value to consumers and that met customer needs and expectations*”.
42. IAG accepts that on the evidence before the Commission it would be open to the Commission to find that Swann did not promote sales practices that focused on delivering value to customers and met customer needs and expectations and thereby Swann’s conduct fell below community standards and expectations.
43. Counsel assisting submitted that the fourth instance of conduct falling below community standards and expectations by Swann that the Commission was open to find was “*failing to investigate the appropriateness of its add-on insurance products or the sales practices of its authorised representatives in a timely manner*”.
44. IAG accepts on the evidence before the Commission it would be open to the Commission to find that Swann’s conduct fell below community standards and expectations by failing to investigate the appropriateness of its add-on insurance products or the sales practices of its authorised representatives in a timely manner.
45. Counsel assisting submitted that the fifth instance of conduct falling below community standards and expectations by Swann that the Commission was open to find was “*failing to redesign the add-on insurance products and the remuneration and incentive arrangements after first becoming aware of ASICs concern in late 2013*”.
46. In response to concerns raised by ASIC, or identified by Swann as a result of its reviews set out in paragraph 10 above, Swann made a number of changes to its product design, pricing and procedures as set out in paragraph 14 above.
47. However IAG accepts that on the evidence before the Commission it would be open to the Commission to find that Swann’s failing to take steps additional to those set out above to re-design its add-on insurance products and remuneration and incentive arrangements after first becoming aware of ASIC’s concerns in September 2015, was conduct falling below community standards and expectations.

D. CAUSES OF THE CONDUCT FALLING BELOW COMMUNITY STANDARDS OR EXPECTATIONS

48. Counsel assisting submitted that:

Swann's misconduct and conduct falling below community standards and expectations is attributable to Swann's culture in at least two respects. First, that culture placed the pursuit of profit and the maintenance of market share above the interests of its customers by designing its remuneration and incentive programs in a way that promoted sales. Second, Swann's culture prioritised the interests of motor dealers over the interests of consumers.

49. As explained above, IAG does not accept that Swann engaged in misconduct but does accept that on the evidence before the Commission it would be open to the Commission to find that Swann's conduct fell below community standards and expectations in the ways identified above.

50. In particular, while Swann's commission structures, remuneration and incentive programs were comparable to all the participants in the industry at the time, IAG accepts that on the evidence before the Commission it would be open to the Commission to find that those structures, remuneration and incentive programs did foster a sales culture where consumers may have been sold products that did not deliver the value they should have⁴⁴ and prioritised the interests of motor dealers over the interests of consumers.⁴⁵

51. Counsel assisting has also submitted that:

It is open to the Commission to find that a further cause was Swann's governance practices which did not properly supervise or audit the activities of its authorised representatives.

52. As set out in paragraphs 17 to 26 and 28 above, Swann had in place agreements which required authorised representatives to comply with their obligations, training as well as electronic compliance questionnaires. While Swann accepts that the face to face audits of customers would have been best practice, the Commission should not find that a further cause of Swann's conduct falling below community standards and expectations was Swann's governance practices.

53. In closing, counsel assisting submitted that:

And, finally, it is open to the Commissioner to find that the conduct can be attributed to IAG's governance practices which due to the devolved business model failed to appropriately supervise and monitor the operations of its wholly owned subsidiary Swann.⁴⁶

54. IAG submits that on the evidence an adverse finding regarding IAG's governance practices is not open to the Commissioner. While IAG accepts that there could have been greater supervision of Swann, as noted above, Swann was effectively a standalone business that had its own Australian financial services licence, its own management structures, its own legal and risk and compliance structures.⁴⁷ Further,

⁴⁴ 6106:20-22; see also witness statement of Benjamin Bessell at [105].

⁴⁵ 6098:40-41; see also witness statement of Benjamin Bessell at [105].

⁴⁶ T 6505:7-10.

⁴⁷ T 6137:35-39.

a substantial part of the problem with Swann's conduct related to the industry wide problem of commissions in add-on insurance. In those circumstances, Swann's conduct falling below community standards and expectations cannot be attributed to IAG's governance practices.

E. CONCLUSION

55. In conclusion, while the Commissioner could find that Swann's conduct fell short of community standards and expectations in the ways and for the reasons set out above, there is no basis for a finding of misconduct against either Swann or IAG.

Jeremy Stoljar
Eight Selborne Chambers

D.J.A. Mackay
PG Hely Chambers

Counsel for IAG

Date: 1 October 2018