



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

# **Reforms to General and Life Insurance**

## **Background Paper 27**

This paper was prepared by Treasury in response to a request made by the  
Royal Commission.



**Australian Government**

**The Treasury**

# **FINANCIAL SERVICES ROYAL COMMISSION**

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## **REQUEST FOR INFORMATION REFORMS TO GENERAL AND LIFE INSURANCE**

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## INTRODUCTION

1. Insurance plays an important role within the Australian economy by enabling individuals, firms or other bodies to seek protection against financial losses or adverse events. A well-functioning insurance sector contributes to the appropriate allocation of risks domestically and internationally. More broadly insurance contributes to the availability of financing to enterprises and households; can encourage innovation and longer-term planning; and contributes to financial market efficiency through reducing the cost of uncertain events.
2. In Australia the insurance market is segmented between general insurance, comprising personal and commercial lines, and life insurance, comprising risk products (including death, disability and income protection) and investment products. There is also a reinsurance market which provides insurance to the insurers.
3. The regulatory framework for general and life insurance is similar to that of the banking sector, with financial soundness being regulated by the Australian Prudential Regulation Authority (APRA), and products, disclosure and conduct by the Australian Securities and Investments Commission (ASIC).
4. At the request of the Royal Commission, this Paper discusses recent and prospective reforms affecting the general and life insurance sectors.<sup>1</sup> Many of the reforms enhance ASIC's oversight and capacity to intervene in the industry. This includes civil penalty provisions for a breach of the duty of utmost good faith, unfair contract terms (UCT) provisions, conflicted remuneration provisions, and the Design Distribution Obligations and Product Intervention Powers. Some reforms are intended to bring the insurance industry into line with the broader financial sector and economy-wide laws (conflicted remuneration and UCT provisions). The Design Distribution Obligations and the Product Intervention Powers are new proposals that will apply to a range of financial products, including insurance products. The Paper also discusses relevant reforms undertaken by APRA, ASIC and the insurance industry (including through Industry Codes of Practice).

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1 Various reforms that relate to general insurance have been previously discussed in *Natural disaster insurance*, Background Paper 20 to the Royal Commission on Misconduct in the Banking, Superannuation and Financial Services Industry – to avoid duplication, this paper does not seek to revisit those reforms.

5. A competitive insurance market should place downward pressure on premiums, ensure that products perform appropriately, and respond to consumers' needs for different products and levels of cover. Only in the event of market failure has there been seen to be a case for government to intervene directly in the market, such as subsidising premiums or mandating products. Market failure could arise from anti-competitive arrangements, or, as in the case for terrorism insurance for commercial property, from a response to major events that leads insurers to exit the market.
6. A key focus of the regulation of insurance markets in Australia, particularly in recent times, has been to enhance the disclosure and conduct obligations that apply to insurers. A fair and well-functioning insurance sector requires well-informed consumers. Consumers' ability to make appropriate choices on insurance can be enhanced by the availability and accessibility of relevant information. However, while effective disclosure is essential, insurance products are inherently complex — they require consumers to assess risks and uncertain future circumstances to determine their insurance needs. Recognising this complexity, reforms have also sought to ensure that insurance products are designed and perform appropriately.
7. Two Parliamentary inquiries have been held recently into the general and life insurance industries.<sup>2</sup> The Productivity Commission has also looked at aspects of both general and life insurance industries in their work in relation to competition in the Australian financial system and in assessing the competitiveness and efficiency of the superannuation system.<sup>3</sup>

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2 Parliamentary Joint Committee on Corporations and Financial Services 2018, *Life Insurance Industry*, March; Senate Economics References Committee 2017, *Australia's general insurance industry: sapping consumers of the will to compare*, August.

3 Productivity Commission 2018, *Superannuation: Assessing efficiency and competitiveness*, Draft report, April; Productivity Commission 2018, *Competition in the Australian Financial System*, Report, August.

# REFORMS TO ENSURE PRODUCTS ARE DESIGNED, DISTRIBUTED AND PERFORM APPROPRIATELY

## Enhancing ASIC's powers

8. The *Insurance Contracts Act 1984* (IC Act) makes utmost good faith an implied term of the insurance contract.<sup>4</sup> The duty of utmost good faith is an obligation on the insurer to deal with the policy owner 'openly, honestly and fairly'.<sup>5</sup>
9. The IC Act was independently reviewed in 2003-04.<sup>6</sup> The Review recommended that a breach of the duty of utmost good faith should be both a breach of an implied contractual term and a breach of the IC Act.<sup>7</sup> The Review also made several recommendations aimed at improving the operation of the Act through correcting deficiencies and clarifying ambiguities in its operation.<sup>8</sup>
10. The resulting *Insurance Contracts Amendment Act 2013* (IC Amendment Act) streamlined requirements and addressed anomalies in the regulatory framework for the benefit of insurers and consumers.<sup>9</sup> In key areas, the IC Amendment Act clarified terms in the IC Act.<sup>10</sup>
11. Prior to 2013, parties could only enforce compliance with the implied duty of utmost good faith through private legal action. The then Government noted that this action posed 'too great an expense for some parties' and did 'not provide long-term solutions to systemic breaches of utmost good faith'.<sup>11</sup>

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4 Section 13, *Insurance Contracts Act 1984*.

5 Enright, I., P. Mann, R. Merkin and G. Pynt 2018, *General Insurance*, Background Paper 14 to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, page 11.

6 In September 2003, the then Government appointed Alan Cameron AM and Nancy Milne to conduct the Review.

7 Treasury 2010, *Review of the Insurance Contracts Act*, Recommendation 1.2, page 3, available: <http://icareview.treasury.gov.au/content/default.asp>

8 Treasury 2010, *Review of the Insurance Contracts Act*.

9 A draft legislative package to address the Review's key recommendations was released for public comment in 2007. In March 2010, following a public consultation process, the Insurance Contracts Amendment Bill 2010 was introduced into the Parliament, but lapsed when the federal election was called. In 2013, a slightly revised bill was re-introduced and passed by the Parliament.

10 The Bill amended section 11(1) of the IC Act to define a 'third party beneficiary', and inserted new subsections 13(3) and 13(4) to extend the duty of utmost good faith to third party beneficiaries. Previously, third party beneficiaries were not generally recognised in the IC Act. The Bill also clarified the mixed objective/subjective test in section 21A of the IC Act, which is used to determine if an insured has met their duty of disclosure. Insurance Contracts Amendment Bill 2013, *Explanatory Memorandum*, pages 14-15.

11 Insurance Contracts Amendment Bill 2013, *Explanatory Memorandum*, page 14.

12. To address this issue, the IC Amendment Act made a breach of the duty of utmost good faith a breach of the IC Act. This amendment allowed ASIC to commence or continue representative action on behalf of an insured against an insurer.<sup>12</sup> It also enabled ASIC to access remedies under the *Corporations Act 2001* (Corporations Act) in relation to Australian Financial Services Licence holders.<sup>13</sup>

## Civil penalties for breaches of the duty of utmost good faith

13. In its October 2016 report into life insurance claims, ASIC noted that while it does have licensing powers where there is a breach of the duty of good faith, it would only typically use these powers where there is serious and systemic misconduct. Penalties are not available for breaches of the duty of utmost good faith.<sup>14</sup>
14. In 2017, the ASIC Enforcement Review recommended making section 13 of the IC Act a civil penalty provision to enhance ASIC's use of the provision as an enforcement tool, in circumstances where administrative or representative action may not be appropriate, but action is needed to deter conduct by an insurer that is not consistent with its duty of utmost good faith.<sup>15</sup> ASIC submitted to the Taskforce that the proposed civil penalty where an insurer is found to have breached the duty of utmost good faith would act as a deterrent to inappropriate conduct by insurers, and thereby protect consumers from egregious insurer conduct. It also noted that these civil penalty provisions would mean that ASIC could take action against an insurer where the conduct is not systemic, but nonetheless warrants an enforcement response.<sup>16</sup>
15. The Government has accepted the recommendation and will develop legislative amendments to provide ASIC with powers to impose civil penalties where an insurer breaches the duty of utmost good faith or its obligation to provide a Key Facts Sheet.<sup>17</sup>

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12 Section 13(2) of the IC Act was inserted to this effect. Insurance Contracts Amendment Bill 2013, *Explanatory Memorandum*, page 9.

13 The remedies include a banning order under section 920A of the Corporations Act, suspension or cancellation of the insurer's financial services licence, the imposition of conditions on the licence or the acceptance of an enforceable undertaking. Insurance Contracts Amendment Bill 2013, *Explanatory Memorandum*, page 10.

14 Australian Securities and Investments Commission 2016, *Life insurance claims: An Industry review*, Report 498, page 14.

15 ASIC Enforcement Review 2017, *Strengthening penalties for corporate and financial sector misconduct*, *Positions Paper 7*, page 67.

16 ASIC Enforcement Review 2017, *Strengthening penalties for corporate and financial sector misconduct*, *Positions Paper 7*, pages 46-47.

17 Australian Government 2018, *Response to the ASIC Enforcement Review Taskforce Report*, April, page 12. The Taskforce recommended extending the civil penalty regime to several

## Unfair contract terms

16. In 2010, unfair contract terms (UCT) laws were introduced which apply to all sectors of the economy and to all businesses operating in those sectors that use standard form contracts in their dealings with consumers. In 2016, these laws were extended to provide protections to small businesses from UCT.<sup>18</sup>
17. UCT laws in the Australian Consumer Law (ACL) protect consumers and small businesses from the use of unfair terms in standard form contracts. A term of a consumer contract is unfair if it:
  - would cause a significant imbalance in the parties' rights and obligations arising under the contract; and
  - is not reasonably necessary to protect the legitimate interests of the party who would be advantaged by the term; and
  - would cause detriment (whether financial or otherwise) to a party if it were applied or relied on.<sup>19</sup>
18. While the UCT laws apply to most financial products and services, they do not currently apply to insurance contracts regulated under the IC Act. Section 15 of the Act states that a contract of insurance is not capable of being made the subject of relief under any other Act.<sup>20</sup> Therefore, the UCT provisions in the ACL and the *Australian Securities and Investments Commission Act 2001* (ASIC Act) do not apply to insurance contracts.
19. In 2013, the Insurance Contracts Amendment (Unfair Terms) Bill, which would have extended UCT laws to general insurance, was introduced but lapsed when Parliament was prorogued when the 2013 federal election was called.<sup>21</sup>

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provisions in the Corporations Act. The full list is provided at pages 90-91 of the Taskforce Report.

18 Section 23, Australian Consumer Law, Schedule 2, *Competition and Consumer Act 2010*.

19 Section 24(1), Australian Consumer Law, Schedule 2, *Competition and Consumer Act 2010*; Section 12BG, *Australian Securities and Investments Act 2001*.

20 Section 15, *Insurance Contracts Act 1984*.

21 In 2010, the then Government released an options paper on unfair contract terms in insurance contracts to formulate its response to the Senate Economics Legislation Committee's 2009 inquiry into the provisions of the ACL Bill. The paper proposed several options to prevent consumers of standard form general insurance contracts from suffering detriment due to terms in the contract that are unfair or harsh. See Australian Government 2010, *Unfair terms in insurance contracts—Options paper*, pages 6-7. Following consultation on these options, in December 2012 it was announced that amendments would be made to the IC Act by implementing a separate set of UCT laws for standard form contracts of general insurance. For detail on the consultation process, see Insurance Contracts Amendment (Unfair Terms) Bill 2013, *Explanatory Memorandum*, pages 94-96.

20. In March 2017, the final report of the Consumer Affairs Australia and New Zealand (CAANZ) Review of the ACL recommended applying UCT protections to contracts regulated under the IC Act.<sup>22</sup> The Review responded to industry concerns relating to the high compliance costs of UCT laws by noting that similar protections applying to insurance contracts in the United Kingdom and New Zealand had ‘not appeared to pose a significant barrier to most traders in continuing their business’.<sup>23</sup>
21. In June 2018, Treasury began consulting on a Proposals Paper to extend UCT laws to insurance contracts relating to both life and general insurance.<sup>24</sup> The paper proposed that section 15 of the IC Act be amended to allow the UCT laws in the ASIC Act to apply to insurance contracts. This amendment would provide insureds with the same protections as consumers under the ACL.

## Improving claims handling

22. Treasury highlighted the issue of poor claims handling practices in its Background Paper to the Commission on natural disaster insurance. It noted the failure by insurers to process claims in a timely manner, to collect and use evidence, to communicate adequately the refusal of claims, and to inform consumers of their rights to dispute resolution.<sup>25</sup> Similar problems have also arisen in the life insurance sector, including in relation to insurance in superannuation.
23. In April 2016, ASIC formally investigated public claims that CommInsure was using outdated wording for certain medical definitions, and placing pressure on medical staff to change their assessments to delay or deny claims.<sup>26</sup> ASIC found no evidence to support allegations that CommInsure claims managers applied undue pressure on doctors to change or alter their medical opinions. It did find that CommInsure needed better and more timely communications with insurers and enhanced training and assistance for claims managers.<sup>27</sup>

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22 Consumer Affairs Australia and New Zealand 2017, *Australian Consumer Law Review: Final Report*, March, Proposal 10, page 53.

23 Consumer Affairs Australia and New Zealand 2017, *Australian Consumer Law Review: Final Report*, March, page 54.

24 Treasury 2018, *Proposals paper: Extending unfair contract terms protections to Insurance Contracts*, June.

25 Treasury 2018, *Natural disaster insurance*, Background Paper 20 to the Royal Commission on Misconduct in the Banking, Superannuation and Financial Services Industry, pages 11-12.

26 Australian Securities and Investments Commission 2017, *Report on ASIC’s investigation into the Colonial Mutual Life Assurance Society Limited*, March.

27 Australian Securities and Investments Commission 2017, *Report on ASIC’s investigation into the Colonial Mutual Life Assurance Society*, 23 March, available: <https://asic.gov.au/regulatory-resources/find-a-document/reports/attachment-to-17-076mr-report-on-asics-investigation-into-the-colonial-mutual-life-assurance-society-limited/>

24. In May 2016, APRA wrote to 25 selected registrable superannuation entity (RSE) licensees to request information on RSE licensee claims oversight and governance under group insurance arrangements. APRA reviewed the information provided in response. In October 2016, it wrote to RSE licensees with a summary of key themes, identifying where claims and governance oversight were effective across the RSE licensees, and where further work was needed to meet APRA's expectations.
25. The claims made against CommInsure also led ASIC to conduct an industry-wide review of claims handling processes. The resulting report identified a number of areas of concern with insurance claims handling practices. ASIC made several commitments to act, and placed a number of expectations on insurers.<sup>28</sup> One of ASIC's commitments was to establish, with APRA, a new public reporting regime for life insurance industry claims data and claims outcomes. This is discussed below.
26. ASIC's 2016 report into life insurance claims also proposed changing the law to allow ASIC to enhance its capacity to seek improvements in the claims handling process.<sup>29</sup> The regulatory framework for ASIC's oversight role is largely provided by Chapter 7 of the Corporations Act.<sup>30</sup> However, at the moment insurance claims handling largely falls outside of this framework as:
- many of the activities undertaken in relation to insurance claims handling would not fall within the current definition of providing a financial service under the Corporations Act; and
  - those activities carried on in the course of handling an insurance claim that would normally be considered a financial service are in effect excluded by Corporations Regulations.
27. In October 2016, the Government asked Treasury 'to undertake targeted consultation on the merits of removing the exemption for claims handling practices'.<sup>31</sup> This work is now on hold until the conclusion of the Royal Commission.

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28 Australian Securities and Investments Commission 2016, *Life insurance claims: An industry review*, Report 498, page 4.

29 Australian Securities and Investments Commission 2016, *Life insurance claims: An industry review*, Report 498, pages 101-102.

30 ASIC currently uses its jurisdiction under the consumer protection powers in Division 2 of Part 2 of the Australian Securities and Investments Act 2001 (ASIC Act) to exercise some regulatory oversight of insurance claims handling conduct. However, these powers have limits and do not help to address poor consumer outcomes resulting from conduct that is not a financial service (for example, unreasonable investigations and failure to make a decision in a timely way). It also does not assist where the conduct is not clearly a breach of the ASIC Act provisions, but may otherwise be contrary to the general obligations.

31 The Hon. Kelly O'Dwyer MP 2016, 'Release of ASIC report on claims handling in life insurance industry', *Media Release*, 12 October.

## Design and Distribution Obligations and Product Intervention Powers

28. While effective disclosure is important to assist consumers in their understanding and selection of appropriate financial products, including insurance products, a range of factors can render disclosure ineffective. Consumers may display behavioural biases, they may be disengaged, have misaligned interests and low financial literacy. Even the availability of sound financial advice may not overcome these issues.<sup>32</sup>
29. In 2015, the Government committed to introduce a targeted and principles-based product design and distribution obligation, and financial product intervention powers. These were key recommendations of the Financial System Inquiry (FSI).<sup>33</sup> The purpose of these reforms is to ensure that financial products are targeted and sold to the right consumers, and where they are inappropriately targeted or sold, ASIC will have the power to intervene to prevent consumer harm.<sup>34</sup>
30. In December 2016, the Government issued a proposals paper on these measures. In December 2017, it released exposure draft legislation intended to achieve these reforms.<sup>35</sup> The Government is currently holding a second round of consultation on the legislation. The consultation period formally ended on 24 August 2018.<sup>36</sup>
31. For most life and general insurance products, the design and distribution obligations will require:
- issuers to identify appropriate target markets and distribution channels for products, having regard to the features and characteristics of products and consumers in those target markets;

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32 Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018, Exposure Draft, *Explanatory Memorandum*, page 4.

33 Commonwealth of Australia 2014, *Financial System Inquiry: Final Report*, recommendations 21 and 22.

34 The Hon. Kelly O'Dwyer 2018, Minister for Revenue and Financial Services, 'Turnbull Government seeks further comment on law to improve outcomes for financial consumers', *Media Release*, 20 July.

35 Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2017 (Cth), Schedule 1; Exposure Draft Explanatory Memorandum, Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018 (Cth).

36 Treasury 2018, Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Power) Bill 2018, *Consultation*, May, available: <https://treasury.gov.au/consultation/c2018-t312297/>

- distributors to implement reasonable distribution controls so that products are likely to be distributed to individuals in the target market; and
  - that these arrangements be periodically reviewed to ensure they are appropriate.
32. The product intervention powers would enable ASIC to intervene where it is satisfied that an insurance (or other financial) product has resulted in, will, or is likely to result in significant consumer detriment. ASIC would have the capacity to issue a consumer warning, require labelling change and, in serious cases, ban the product.

## Banning conflicted remuneration for life insurance advice

33. Under the Future of Financial Advice (FoFA) reforms, benefits paid in relation to life risk insurance outside of superannuation were exempted from the ban on conflicted remuneration that applied more generally to advice.<sup>37</sup>
34. In its October 2014 *Report 413 – Review of Retail Life Insurance Advice*, ASIC found that the upfront commission structure created an incentive for advisers to replace consumers’ existing life insurance policies unnecessarily (commonly known as churn), a practice that was causing consumer harm.<sup>38</sup> Further, ASIC noted that its findings suggested that where an adviser is paid under an upfront commission model it has ‘a statistically significant bearing on the likelihood of that adviser giving advice that did not comply with the law’.<sup>39</sup>
35. The *Corporations Amendment (Life Insurance Remuneration Arrangements) Act 2017* legislated to:
- remove the exemption for life insurance from the ban on conflicted remuneration (introduced under the FoFA reforms);
  - allow for level commissions to be paid;

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37 Further detail on these reforms is provided in *Key reforms in the regulation of financial advice*, Background Paper 8 to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry.

38 Australian Securities and Investments Commission 2014, *Review of Retail Life Insurance*, Report 413, October, page 5.

39 Australian Securities and Investments Commission 2014, *Review of Retail Life Insurance*, Report 413, October, page 42.

- provide ASIC with the power to set caps on the maximum commission that can be paid, with the relevant caps set by ASIC through a legislative instrument;<sup>40</sup> and
  - introduce two-year commission clawback arrangements (from 1 January 2018).
36. The reforms apply to both personal and general financial advice. They included reforms to direct sales (where often no advice is provided) by prohibiting certain benefits paid in relation to information given to a person in relation to a life insurance product.
37. The reforms commenced from 1 January 2018 and ASIC has responsibility for reviewing the effect of the reforms in 2021.

## Legacy products

38. The products that the life insurance industry offers are continually revised and updated. Products are often deemed uneconomic or dated as a result of changes in market structure, government policy or legislation.<sup>41</sup> These legacy products increase costs to insurers, which may be passed on to consumers. They may also increase operational risks in the management of products, which can lead to administrative errors that affect consumers. In rationalising these outdated products consumers and the industry can benefit from new, more efficient products.
39. There are challenges to achieving this rationalisation of legacy products fairly and effectively. For example, a capital gains taxation (CGT) taxing point may arise if life company assets are transferred to another life company or a custodial arrangement as part of the rationalisation.<sup>42</sup>

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40 ASIC subsequently issued a legislative instrument which set the maximum commission cap at 80 per cent of the initial premium upfront from 1 January 2018, phasing down to 60 per cent upfront from 1 January 2020 and 20 per cent of the ongoing premium in subsequent years from 1 January 2018.

41 Commonwealth of Australia 2014, *Financial System Inquiry: Final Report*, page 274.

42 Treasury 2009, 'Product Rationalisation of Managed Investment Schemes and Life Insurance Products', *Proposals Paper*, page 15.

40. In 2014, the FSI recommended introducing a mechanism to facilitate the rationalisation of legacy products in the life insurance industry.<sup>43</sup> The Government agreed to facilitate this process. It stressed the importance of ensuring that consumers should not be worse off due to a transition to a newer product. The Government also noted the possible tax implications of transitioning from legacy products.<sup>44</sup> This work has not yet commenced.
41. However, APRA has been encouraging the life insurance industry to invest in better data processes and systems to administer claims on legacy products more fairly, accurately and efficiently.<sup>45</sup>

## Insurance in superannuation

42. A significant proportion of life insurance policies in Australia are provided through superannuation. Rice Warner estimates that in 2016 more than 70 per cent of policies were held through superannuation funds.<sup>46</sup>
43. Superannuation trustees are permitted to obtain death, total and permanent disability (TPD) and income protection insurance policies on behalf of fund members.<sup>47</sup> The insurance covenant in the *Superannuation Industry (Supervision) Act 1993* (SIS Act) requires trustees to formulate, review regularly and give effect to an insurance strategy for the benefit of all beneficiaries. In addition, trustees are only allowed to offer or acquire insurance of a particular kind, or at a particular level, if the cost of insurance does not inappropriately erode the retirement income of its beneficiaries.
44. Requirements for trustees in respect of insurance are also set out in APRA's *Prudential Standard SPS 250 Insurance in Superannuation*, which seeks to ensure that trustees have a sound insurance management framework with respect to making insured benefits available to beneficiaries.

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43 Commonwealth of Australia 2014, *Financial System Inquiry: Final Report*, Recommendation 43, page 274.

44 Australian Government 2015, *Government's response to the Financial System Inquiry*, page 18.

45 Australian Prudential Regulation Authority 2017, *Legacy, operational risk and the changing consumer*, Speech by Mr Geoff Summerhayes to the Actuaries Summit, Melbourne, 22 May.

46 Rice Warner 2016, *Insurance through superannuation*, 20 April, available: <http://www.ricewarner.com/insurance-through-superannuation/>

47 The benefit provided by the insurance policy must be consistent with a condition of release under the *Superannuation Industry (Supervision) Regulations 1994*.

45. Trustees of MySuper products are generally required to offer death and TPD insurance on an opt-out basis.<sup>48</sup> Trustees may also decide to offer income protection on an opt-out basis. Trustees of choice products may offer insurance on any basis (that is, default or not), as long as they comply with their obligations under the insurance covenant.
46. The Government's Accountability and Member Outcomes Package will require trustees of MySuper products to undertake an annual assessment of their MySuper products, including whether the insurance strategy for the MySuper product is appropriate and whether the cost of insurance inappropriately erodes the retirement income of the beneficiaries.<sup>49</sup>
47. APRA has announced that it will require trustees to undertake a similar annual assessment in relation to choice products, in which they will be required to consider the insurance outcomes being provided to their members.<sup>50</sup>
48. The Productivity Commission recently found that around 12 million Australians hold life insurance through superannuation, with about 80 per cent of policies provided automatically (requiring members to amend these policies or opt-out if the cover is unsuitable).<sup>51</sup> Most insurance in superannuation is provided on a group basis, in which members are not subject to individual underwriting.
49. The provision of group insurance cover through superannuation can provide benefits for individuals and the broader community. The Productivity Commission has found that group insurance in superannuation pays out a higher proportion of premiums than individual insurance provided outside superannuation.<sup>52</sup> However, there are problems with the provision of insurance cover that does not meet the needs of members and results in excessive balance erosion. These problems are most clearly evident in the case of young people, low balance members and individuals with multiple accounts.

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48 This obligation is subject to 'reasonable conditions'.

49 The Hon. Kelly O'Dwyer 2017, 'Reforms to give consumers more power at the heart of a stronger superannuation system', *Media Release*, 24 July, available: <http://kmo.ministers.treasury.gov.au/media-release/070-2017/>

50 See Draft Prudential Practice Guide 225, available: <https://www.apra.gov.au/sites/default/files/draft%2520SPG%2520225%2520Outcomes%2520assessment.pdf>

51 Productivity Commission 2018, *Superannuation: Assessing Efficiency and Competitiveness*, Draft Report, page 311.

52 Productivity Commission 2018, *Superannuation: Assessing Efficiency and Competitiveness*, Draft Report, page 319.

50. Cameo analysis by the Productivity Commission shows that while an average worker may only experience a four per cent lower retirement balance as a result of holding death and TPD cover through superannuation, a low income intermittent worker with multiple accounts including death, TPD and income protection cover could lose 28 per cent of their potential retirement balance in insurance premiums.<sup>53</sup>
51. In response to concerns about the appropriateness of default insurance in superannuation and the resulting erosion of superannuation balances, the Government announced reforms to insurance in the 2018–19 Budget. A key objective of the *Protecting Your Super Package* is to protect superannuation savings from undue and inappropriate erosion by insurance premiums.<sup>54</sup>
52. The Package will do this by preventing trustees offering death and TPD insurance on a default basis to members aged under 25 and members who have an account balance of less than \$6,000. It will also require trustees to cease insurance cover on inactive accounts after a period of 13 months. Members will still be able to opt-in to group insurance cover if they wish. To facilitate this process, the Package will place new obligations on trustees to advise members in relation to their insurance cover.
53. These changes are scheduled to take effect from 1 July 2019.
54. The Government also previously tasked APRA with ensuring that trustees make it easy for people to opt-out of default insurance under existing rules.<sup>55</sup> APRA is currently consulting on measures to achieve this, which it intends to finalise early next year.

## REFORMS TO IMPROVE DISCLOSURE AND TRANSPARENCY

55. Clear, concise and timely disclosure of relevant product information is crucial to consumers' ability to make well informed purchasing decisions on insurance products. In response to the Senate Economics References Committee's 2017 report into general insurance, the Government has tasked Treasury with reviewing product disclosure regimes for general insurance.

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53 Productivity Commission 2018, *Superannuation: Assessing Efficiency and Competitiveness*, Draft Report, page 326.

54 Treasury 2018, *Protecting Your Super Package*, 8 May, available: <https://treasury.gov.au/consultation/c2018-t286292/>

55 The Hon. Kelly O'Dwyer MP 2017, 'Reforms to give consumers more power at the heart of a stronger superannuation system', *Media Release*, 24 July.

56. General insurance disclosure is not merely for the purpose of providing consumers with information. It is crucial that this information is presented in a way that provides consumers with the capacity to make informed and appropriate decisions about the insurance coverage they purchase. As part of the review, Treasury will be considering the need to:
- enhance the transparency of general insurance pricing to require insurers to disclose the previous year's premium on renewal notices;
  - amend the Corporations Act to provide component pricing of premiums to policyholders;
  - initiate a review of current disclosure requirements for standard cover;
  - enhance comparability of insurance products through standardising definitions for key terms; and
  - review the effectiveness of the Key Facts Sheet (KFS) as a means of product disclosure in improving consumer understanding of home building and home contents policies, and the merit of extending the use of KFS to other forms of general insurance.

## Public reporting of life insurance claims outcomes

57. An important means to achieve a well-functioning and trusted system of insurance is a transparent basis for reporting claims. Just as consumers benefit from clear and concise product information, so too can their decisions benefit from information on the industry's payment of claims. In its 2016 report on life insurance claims, ASIC concluded that to improve public trust in the industry, there is 'a clear need for better quality, more transparent and more consistent data on life insurance claims'.<sup>56</sup>

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56 Australian Securities and Investments Commission 2016, *Life insurance claims: An Industry review*, Report 498, page 11.

58. ASIC and APRA have both committed to improve transparency and accountability in the life insurance industry through a consistent public reporting regime for claims data and claims outcomes. In its 2016 report, ASIC noted that it will work with APRA to establish and oversee a new public reporting regime for life insurance industry claims data and claims outcomes.<sup>57</sup> It identified that a public reporting system will enable the regulators to monitor claims trends and identify potential issues of concern.<sup>58</sup> APRA has highlighted that a public reporting system ‘can improve competition between insurers, increase the efficiency of claims handling and reporting by insurers and generally enhance the financial safety of the life insurance sector’.<sup>59</sup>
59. Establishing the public reporting regime involves three pilot rounds of data collection ahead of the implementation of the formal reporting regime. The first two rounds of data collection have been completed. The results from the first round (relating to claims in 2016) and from the second round (relating to claims from 1 January 2017 to 30 June 2017) were consistent with ASIC’s 2016 finding that more than 90 per cent of claims that go to decision are paid in the first instance.<sup>60</sup>
60. The public reporting regime is the first project to formalise common definitions relating to claims handling across the industry. APRA noted in publishing the first round of data that more work still needed to be done to embed common definitions fully.<sup>61</sup> The second round of collection improved data quality, with insurers able to report on common definitions. APRA and ASIC’s work, in consultation with industry, is ongoing.

## INDUSTRY CODES OF PRACTICE

61. There is an important role for the insurance industry in Australia to self-regulate to show to current and prospective consumers the standards to which it commits. In this regard, Industry Codes of Practice are important.

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57 Australian Securities and Investments Commission 2016, *Life insurance claims: An Industry review*, Report 498, page 10.

58 Australian Securities and Investments Commission 2016, *Life insurance claims: An Industry review*, Report 498, page 93.

59 Australian Prudential Regulation Authority 2017, ‘Towards a transparent public reporting regime for life insurance claims information’, *Discussion paper*, May, page 7.

60 Australian Prudential Regulation Authority 2018, ‘APRA and ASIC release new life claims data’, *Media Release*, 24 May.

61 Australian Prudential Regulation Authority 2017, ‘APRA and ASIC publish key industry data on life insurance claims’, *Media Release*, 9 November.

62. The General Insurance Code of Practice was first introduced in 1994, and has been reviewed five times, with the most recent version taking effect on 1 July 2014. Two Life Insurance Industry Codes of Practice have recently been introduced: the Life Insurance Code of Practice and the Insurance in Superannuation Voluntary Code of Practice.<sup>62</sup>
63. In 2017, the ASIC Enforcement Review Taskforce recommended that ASIC's ability to influence the effectiveness of codes could be enhanced by shifting to a co-regulatory model. Under this model, industry participants would be required to subscribe to an ASIC-approved code, and in the event of non-compliance with the code, an individual customer would be entitled to seek appropriate redress through the participant's internal and external dispute resolution arrangements. The Taskforce also recommended that ASIC should approve the content and governance arrangements for relevant codes.<sup>63</sup>
64. The Government has accepted the recommendations of the Taskforce report in principle pending the Royal Commission's final report.<sup>64</sup>

## The General Insurance Code of Practice

65. The General Insurance Code of Practice sets out standards that general insurers must meet when providing services to their customers. Insurers must provide services to their customers in an 'open, fair and honest' way. The Code establishes timeframes for insurers to respond to claims, complaints and requests for information from customers, and requires insurers to provide assistance to individuals in financial hardship. It provides options to policyholders in disputes.
66. The Insurance Council of Australia (ICA) owns the Code. The General Insurance Code Governance Committee monitors and enforces the Code.<sup>65</sup> The Code has not been submitted to ASIC for approval.
67. In June 2018, the ICA released the final report of its recent review of the General Insurance Code of Practice. The report made 30 recommendations, including that the Code be updated to include:
- a new principles-based section for consumers experiencing vulnerability and enhanced provisions for consumers experiencing financial hardship;
  - measures to meet ASIC requirements for Code approval;

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62 In addition to these Codes, the National Insurance Brokers Association Code sets out minimum service standards for insurance brokers.

63 ASIC Enforcement Review Taskforce 2017, pages xi, xv and Chapter 4, December.

64 Treasury 2018, 'Natural disaster insurance', *Background Paper 20 to the Royal Commission on Misconduct in the Banking, Superannuation and Financial Services Industry*, page 13.

65 Financial Ombudsman Service 2018, *General Insurance Code of Practice*.

- requirements that insurers have policies in place to document their processes for designing and distributing products; and
- various disclosure requirements relating to the renewal of policies.<sup>66</sup>

## The Life Insurance Industry Code of Practice

68. On 1 July 2017, a Life Insurance Code of Practice commenced operating. The Financial Services Council (FSC) owns and publishes the Code. All FSC life insurance members are signatories.<sup>67</sup>
69. The Code sets out the life insurance industry's key commitments and obligations to customers on standards of practice, disclosure and principles of conduct for their life insurance services. The Code also sets out timeframes for insurers to respond to claims, complaints and requests for information from customers.
70. The Code covers many aspects of a customer's relationship with an insurer, from buying insurance to making a claim, to providing options to those experiencing financial hardship or requiring additional support. The Code does not currently apply to financial advice companies, financial advisers and superannuation fund trustees.
71. The Life Insurance Code Compliance Committee independently monitors and enforces the Code, and can sanction insurers for a breach.<sup>68</sup>
72. The Government has encouraged the FSC and the life insurance industry to gain ASIC approval of the Code. In this context, the Minister for Revenue and Financial Services has stated that 'ASIC approval will strengthen consumer confidence in the Code by ensuring, among other things, that it meets ASIC's standards on remedies for consumer complaints'.<sup>69</sup>
73. On 27 July 2018, the FSC announced that the Life Insurance Code would be extended to bind the Council's 15 superannuation trustee members. The FSC noted that with the inclusion of superannuation trustees, the Life Insurance Code contains the minimum service standards expected from both insurers and superannuation trustees in relation to all aspects of life insurance.<sup>70</sup>

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66 Insurance Council of Australia 2018, *Final report: Review of the General Insurance Code of Practice*, June.

67 Financial Services Council, *Life Insurance Code of Practice: Policy*, available: <https://www.fsc.org.au/policy/life-insurance/code-of-practice/>

68 Financial Ombudsman Service 2018, *Life Insurance Code of Practice*, available: <https://www.fos.org.au/about-us/codes-of-practice/life-insurance-code-of-practice/>

69 The Hon. Kelly O'Dwyer MP 2018, 'Address to the Financial Services Council Life Insurance Conference', *Speech*, Sydney, 21 March, available: <http://kmo.ministers.treasury.gov.au/speech/007-2018/>

70 Financial Services Council 2018, 'Life insurance consumers to get better outcomes from two new FSC initiatives', *Media Release*, 26 July.

## Insurance in Superannuation Voluntary Code of Practice

74. In late 2016, the insurance and superannuation industries—the Australian Institute of Superannuation Trustees (AIST), the Association of Superannuation Funds of Australia (ASFA), the FSC, Industry Funds Forum (IFF), Industry Super Australia (ISA), representative life insurers, superannuation funds and consumer advocates—formed the Insurance and Superannuation Working Group (ISWG) to develop a Code of Practice for superannuation trustees. The ISWG developed, and ultimately published a Code for superannuation trustees in December 2017.<sup>71</sup>
75. The Code came into effect on 1 July 2018, with a three year transition period for trustees. The Code is voluntary and covers issues such as benefit design, cessation of cover, claims handling, premium adjustment mechanism policies and disclosure, communications with members and dispute resolution. A transition committee, including AIST, ASFA, the FSC, superannuation funds, insurers and administrators, is facilitating the implementation of the Code and issuing guidance to assist trustees in meeting their commitments under the Code. Most of the largest superannuation funds have indicated that they will adopt the Code.<sup>72</sup>

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71 The finalised code was published by the code owners AIST, ASFA and the FSC on 18 December 2017. Insurance in Superannuation Voluntary Code of Practice, available: <http://www.aist.asn.au/policy/insurance-in-superannuation-voluntary-code-of-practice/insurance-in-superannuation-voluntary-code-of-practice.aspx>

72 Roddan, M. 2018, 'AMP baulks at insurance code', *The Australian*, 17 April.