

Mr Geoff Miller
Director, Corporations & Financial Services Division
Treasury
Langton Crescent
PARKES ACT 2600

25 February 2011

Dear Mr Miller

FUTURE OF FINANCIAL ADVICE (FOFA): GENERAL INSURANCE ISSUES

The Insurance Council of Australia Limited¹ (Insurance Council) appreciates the ability to participate in the discussions of the FOFA Peak Consultation Group (PCG). We particularly welcomed the opportunity to discuss the general insurance aspects of FOFA with you, Vicki Wilkinson and other members of your team on 20 January prior to the PCG meeting on 24 January 2011 which focused on insurance matters. This submission provides the view of the Insurance Council on the key issues relevant to general insurers.

In considering further regulation of general insurance, the Insurance Council works from the perspective that Australian retail consumers of general insurance already enjoy a strong regulatory regime comprised not only of the Corporations Act but also the comprehensive provisions of the Insurance Contracts Act. Consumers also receive the further protections of the ASIC Act and the General Insurance Code of Practice and can access alternative dispute resolution through the Financial Ombudsman Service.

In particular, insureds benefit from the common law and statutory duty on both parties to an insurance contract to act with utmost good faith. Although there is no statutory definition of the requirement to act in utmost good faith, it has been held by the Courts that it means to act with scrupulous fairness and honesty and the courts have broadly interpreted this concept. Gleeson CJ and Crennan J in *CGU v AMP (2007) HCA 36* stated:

“In particular we accept that utmost good faith may require an insurer to act with due regard to the legitimate interests of an insured, as well as to its own interests.”

The Insurance Council understands that policy changes targeted at other financial services sectors must be pursued within the generic FSR framework. However, against the background of strong protection for general insurance consumers, the Insurance Council urges the Government to apply solutions to problems with advice on investment products in such a way that does not adversely affect key outcomes for insureds such as availability of advice, product choice and price.

¹ The Insurance Council of Australia is the representative body of the general insurance industry in Australia. Our members represent more than 90 percent of total premium income written by private sector general insurers. Insurance Council members, both insurers and reinsurers, are a significant part of the financial services system. September 2010 Australian Prudential Regulation Authority statistics show that the private sector insurance industry generates gross written premium of \$33.8 billion per annum and has total assets of \$101.5 billion. The industry employs approx 60,000 people and on average pays out about \$86 million in claims each working day.

Insurance Council members provide insurance products ranging from those usually purchased by individuals (such as home and contents insurance, travel insurance, motor vehicle insurance) to those purchased by small businesses and larger organisations (such as product and public liability insurance, professional indemnity insurance, commercial property, and directors and officers insurance).

The application of the generic FSR regulatory framework to general insurance has already been adjusted a number of times to better reflect the characteristics of general insurance where policies are typically simple in nature, run for a set period of time, can generally be cancelled at any time and changed at renewal, have a cooling off period and do not involve any risk in terms of lost income or investments.

We submit that the FOFA reforms should similarly be adjusted to reflect the fact that the problems with investment products at which the FOFA initiatives are aimed are not experienced in general insurance products.

Access to Advice

You would be aware from previous submissions that the Insurance Council and its members consider that the FSR regime continues to inhibit general insurers from providing simple advice to consumers. As a result the majority of general insurance is sold on a 'no personal advice' model. If advice is used, it is most likely to be general advice. This impacts on the consumer's ability to make decisions on the most appropriate insurance policy for their needs.

The Insurance Council considers that this lack of simple personal advice has hindered consumers in choosing policies with cover suited to the risks they faced. Consequently, the Insurance Council's Ten Point Response to issues raised by the current floods includes:

"Commitment by government to ensure the advice provisions in the Corporations Act do not impede discussion between consumers and insurers on appropriate insurance cover needs."

The Insurance Council and its members therefore see the FOFA project as an opportunity to further improve the regulatory regime for general insurance to the benefit of consumers as well as insurers. However, it is of serious concern that the initiative to introduce a best interests duty for financial advisers will also apply to the general insurance sector.

Adding such a duty on top of a regime which already deters general insurers from giving simple advice will strongly increase the likelihood that consumers will not receive the appropriate information to make well reasoned choices in relation to their insurance purchases. We consider that, if a best interest duty were to attach to personal advice, it would exacerbate a situation where 'scalability' is already difficult to implement. (That is, a general insurer is only required to make enquiries about the customer's circumstances commensurate with the level of advice the customer actually wants.)

The 'Access to Advice' issues paper for the 13 December 2010 PCG meeting canvassed the option of general advice being extended to cover advice that only makes recommendations in relation to low-risk financial products. Given the difficulties of making a best interests duty work in the context of general insurance (see below), the Insurance Council submits that serious consideration should be given to treating personal advice on general insurance as general advice. This would be limited to where the advice does not compare the policies of different insurers and would mean that personal advice on general insurance products would largely consist of the advice given by insurance brokers.

We are also concerned that the ban on commissions for investment products may be extended to general insurance where general insurance has not experienced the conflicts of

interest problems seen in other sectors (We of course welcomed the Government's decision to consult separately on this issue)

The attachments which follow explore ways of how the FOFA project can preserve and improve consumer outcomes for consumers of general insurance products. The attachments deal with:

- Attachment A – Best Interests Duty
- Attachment B – Access to Advice; and
- Attachment C – Commissions.

For the issues of best interests duty and access to advice which are already being dealt with by the PCG, we thought the most productive way to proceed is to address in this submission the questions posed in the relevant background papers for the last PCG meeting on 13 December 2010. In relation to commissions, the submission addresses the questions posed in the background papers for the PCG meeting of 24 January.

Please contact Mr John Anning, Insurance Council's General Manager Policy – Regulation (tel: (02) 9253 5121; email: janning@insurancouncil.com.au), if you would like to discuss further any of the issues covered in this submission.

Yours sincerely



Robert Whelan
Executive Director & CEO

BEST INTERESTS DUTY

As explained above in the covering letter to this submission, Insurance Council members consider that the current advice regime discourages the provision on simple personal advice and are concerned that the addition of a best interests duty will exacerbate this problem. Please see Attachment B on “Access to Advice” for a more detailed discussion of this issue. However, the answers in this Attachment are given on the assumption that the best interests duty will apply to general insurance.

1.1 What impact would imposing the duty on general advice as well as personal advice have on industry? Would it impact on the willingness of business to offer general advice to retail clients? What steps should a person be required to take in order to comply with the duty when providing general advice?

The Insurance Council joined with other PCG members on 13 December 2010 in arguing that a best interests duty should not be applied to general advice. Imposing the duty on general advice situations would require collection and analysis of information in cases where a retail client is simply seeking an “off the shelf” insurance product. It is logically inconsistent and in practice impossible for anyone giving general advice which, by definition, does not take into account the client’s personal circumstances, to take into account the client’s best interests.

If put into place, a best interests duty on the provision of general advice would impact on the willingness of general insurers that are licensed to provide general advice to continue offering such advice. This would be contrary to the Government’s goal of increasing access to advice at all levels.

1.2 Do you believe that the duty should apply to the implementation and review of advice (in addition to providing advice)?

As general insurance products are short-term contracts, which are renewed annually, the review of advice is generally not relevant to direct sales of general insurance. If review of advice is taken to encompass renewal of general insurance products, it would be inappropriate to extend the best interests duty to simple cases where a retail client expects a policy to automatically renew and does not require a needs analysis.

1.3 Do you agree that the application of the duty should have regard to the circumstances under which the advice was provided? Do you consider this is an effective way of implementing the reasonable steps qualification as announced by the Government?

Yes, the application of the duty should have regard to the circumstances in which the advice is provided. For example, in the provision of personal advice on general insurance products by an employee/representative of an insurer, it would be reasonable for the adviser to only consider the insurance products of the insurer/insurance brand for whom they are authorised to act. This would be explained to the consumer in the FSG that the adviser provides to them.

Furthermore, it is unnecessary when a consumer is dealing with the employee/representative of a general insurer in a situation where it is clear with which licensed insurer they work (for example the customer has entered an insurer's office or rung an insurer's telephone call centre), for the employee/representative to say "I can only advise you in relation to the products of X."

The Insurance Council would like to explore further the position put by some at the 13 December 2010 meeting that those providing personal advice on simple financial products, such as most general insurance products, should as a matter of course consider the other financial products that the customer may already hold. Unless specifically requested by the client and those acting for an insurer agree, an employee/representative of a general insurer should not have to consider a consumer's existing insurance cover when discussing the suitability of a particular type of insurance product.

Employees would not have the familiarity with the products of another insurer to be able to provide anything more than advice limited to their employer's products (which is the role that they are trained for). As a practical matter, consumers will not innocently double insure; the types of general insurance used by most consumers offer distinct cover and there is little risk of consumers unknowingly acquiring duplicate cover.

However, Insurance Council members accept the point that a representative/employee providing personal advice on a limited product set would be bound to tell the client if there was not a policy within that set which would be appropriate to the consumer.

Providing advice on overall insurance needs is a role for an insurance broker or other intermediary rather than an employee (either an AFS licensee in their own right or an authorised representative of a licensee). At this level of service the disclosure requirements of the Corporations Act are sufficient to ensure that an authorised representative of one or more general insurers advises the retail client of the licensee(s) for whom they act.

In order to provide greater clarity, the "reasonable steps" qualification should be further developed into a legislated safe harbour, supported by ASIC guidance. See 1.5 below for more detail.

1.4 Should the test for compliance of the duty be based on a reasonable person or something more tailored (for example, reasonable financial services professional with the adviser's level of competency)?

The Insurance Council considers that the reasonable person test is the simplest and most practical basis for assessing compliance with the duty.

1.5 Do you agree with the proposed definition of the duty and also the proposed matters that a person should have regard to when providing advice?

It may be appropriate in relation to comprehensive, personal advice for the best interests duty to be defined as having proper regard to the financial interests of the client and placing the interests of the client above the interests of the person providing the advice and the providing entity. However, the Insurance Council is concerned that this formulation makes it difficult to "wind back" this standard in order to allow scalable personal advice. It may be worth considering an alternative formulation based on "the stated financial goals of the client"

At the PCG meeting on 13 December 2010, there was a strong preference from participants for a legislated “safe harbour” to replace the proposal in the background paper for explanatory material to set out that the factors which advisers should have regard to when providing personal advice. This is also the Insurance Council’s preference in order to give absolute certainty to those wishing to take advantage of the safe harbour provisions.

The Insurance Council understood from the December PCG meeting that the factors which advisers should have regard to when providing personal advice in the best interests of the client would include:

- (a) the likely benefits of their advice on the financial interests of the retail client, including in the long term;
- (b) the likely risks of their advice to the financial interests of the retail client, including in the long term;
- (c) the comparative risks and benefits of advising the retail client to
 - (i) continue with the financial products which they already hold; or
 - (ii) pursue a financial strategy which does not involve financial products (e.g. mortgage repayments instead of giving advice to acquire new financial products; and
- (d) what was appropriate in the circumstances (precise wording not yet available).

While not disagreeing in principle with the listed factors, there is a concern that, even with (d), the requirements in (a), (b) and (c) may be read too inflexibly. If this was the case, it would make it even harder to persuade licensees that they could provide simple personal advice through scalability of the regulatory requirements. The Insurance Council notes that, apart from ensuring that there is enough lee way in the wording of the explanatory material, there will be a strong need for examples in ASIC’s regulatory guidance as to how scalability will work in practice. (See response below concerning access to advice.)

1.6 What are your views on employee representatives being able to contravene the duty but only the licensee or authorised representative incurring any monetary liability? Would you have concerns if this approach was also extended to the other advice provisions (sections 945A, 945B and 947D)?

Regarding part one of the question, the Insurance Council notes that the current situation imposes the liability on the licensee and we do not see a need to change this approach. The licensee has the responsibility to provide the training and systems which enable the employee/authorised representative to do their job.

However, the Insurance Council notes that, even if employee representatives did not have monetary liability under the Corporations Act, they may still have a direct exposure to monetary liability for professional negligence under the common law. It is also likely that the licensee/authorised representative would also be liable for the employee representative’s professional negligence.²

² For your information, at the PCG meeting of 19 November 2010 the question was raised of the possible impact on the availability and cost of PII of making representatives financially responsible for their advice. After consultation with members of our PII Committee, I can advise that no impact is likely as representatives are already financially liable for professional negligence and PII policies are available to provide cover to:

- the individual representatives; and
- Licensees for the actions of their representatives in most cases.

Furthermore, for the sake of clarity, the Insurance Council draws to Treasury's attention that for a Professional Indemnity Insurance (PII) policy to respond to liability accruing to a licensee or authorised representative for the act of a "representative" (as opposed to an employee), there needs to be a clear line of responsibility between the licensee/authorised representative and representative. The policy will most likely not react if someone has held themselves out to be a representative without the necessary authorisation.

In relation to part two of the question, the Insurance Council agrees with the logic of extending the suggested approach to the other advice provisions of the Corporations Act. That is, the liability should sit with the licensee.

1.7 Given the elements outlined above, do you believe any statutory safe harbour or defences to the duty are necessary? If so, please explain why.

See answer to 1.5 above.

APPLICATION TO SPECIFIC SCENARIOS

The Insurance Council will restrict its comments to scenario two which is the one most directly relevant to general insurance.

Scenario 2:

Bank C offers a term deposit product to its customers and some of the bank tellers employed by the Bank receive remuneration based on sales of term deposits. A customer approaches a bank teller to make a deposit. During this transaction, the bank teller becomes aware that the customer has a large balance in a savings account, which may mean that a term deposit product is suitable for that customer. The bank teller seeks additional information about the customer to determine whether the Bank's term deposit product would be suitable triggering personal advice obligations.

In order to comply with the best interests duty, the bank teller must explain to the customer that they are only in a position to provide advice in relation to the term deposits offered by Bank C. The test for compliance of the best interests duty would then have regard to the advice a reasonable person would have provided given the limited subset of products available to the bank teller. The bank teller will not be in breach of their duty merely because they have only provided advice in relation to Bank C's products.

2.2 Is this an appropriate application of the duty in these circumstances? Are there any special allowances necessary for individuals that provide advice solely in relation to low-risk, simple financial products (like term deposits)?

This scenario has strong similarities to the situation with simple personal advice being provided on general insurance products. (For the purposes of this scenario, we're putting

The impact of requiring PII for the employees/representatives of the large financial institutions is also a non issue because most of these are APRA authorised and so exempt from the licensing requirements to have PII. Regardless of the requirements of the Corporations Act, most would have substantial PII programs already covering themselves and their employees. If the institution's own program does not cover representatives, the representatives are usually required to purchase their own PII cover.

aside issues raised by consumer representatives at the 10 December 2010 PCG meeting and accept that a term deposit is a simple financial product.) Consistent with our comments above in response to questions 1.1-1.7, the Insurance Council cannot see why the bank teller must explain that they are only able to provide advice in relation to term deposits offered by Bank C when the exchange is taking place within a Bank C branch. These limitations would already be clear to the consumer who, from disclosures made at the start of the banking relationship, would be aware of the financial services the bank offers. To require this disclosure every time the possibility of advice arises creates a compliance burden which a failure to comply with may undermine the financial institution's rights in a particular situation.

The Insurance Council endorses the conclusion that the test for compliance of the best interests duty would be applied having regard to the advice a reasonable person would have provided given the limited subset of products available to the bank teller. The bank teller will not be in breach of their duty merely because they have only provided advice in relation to Bank C's products.

Also in line with our previous comments, unless the customer requests more complex advice and the bank teller agrees to provide it, the bank teller should not have to consider the customer's holdings of other financial products. The bank teller is making a helpful suggestion that the customer consider making a term deposit, not providing comprehensive financial advice.

Common sense is needed if the scalability of personal advice is to work. The overall context within which the advice is provided should be considered. Scalability will be a dead concept if comprehensive financial advice is taken to be the default option unless it is specifically agreed otherwise in every situation.

ATTACHMENT B

ACCESS TO ADVICE

Treasury would be aware from the Insurance Council's previous submissions (such as that to Mr Jim Murphy of 18 September 2007) that our members are keen to explore ways of facilitating the ability for general insurers to provide limited advice on their products. Prior to the Financial Services Reform (FSR) Act 2001, general insurers could discuss the suitability of their products with consumers.

However, with the introduction of the FSR regime, discussion of product suitability often touches on a consumer's objectives, financial situation or needs which brings the likelihood that personal advice is being provided. In order not to trigger the need to comply with the onerous personal advice requirements, there has been a significant move by a number of general insurers towards a non advice model.

The following paragraphs explain in detail why the personal advice requirements are a deterrent for general insurers.

Reasonable Basis for the Advice

The requirement to have a reasonable basis for personal advice set out in s945A:

- (1) The providing entity must only provide the advice to the client if:
 - (a) the providing entity:
 - (i) determines the relevant personal circumstances in relation to giving the advice; and
 - (ii) makes reasonable inquiries in relation to those personal circumstances; and
 - (b) having regard to information obtained from the client in relation to those personal circumstances, the providing entity has given such consideration to, and conducted such investigation of, the subject matter of the advice as is reasonable in all of the circumstances; and
 - (c) the advice is appropriate to the client, having regard to that consideration and investigation.

The section is drafted in broad terms appropriate for comprehensive financial planning advice or advice on complex insurance needs. Its application is not readily translated to retail general insurance. ASIC does cite general insurance in Regulatory Guide 175 as a simple product where scalability could be utilised. However, there is currently insufficient guidance on each aspect of personal advice to give general insurers the confidence to provide it.

The scope of relevant personal circumstances needs first to be limited to the type of insurance the consumers is interested in. For example, with an inquiry to a call centre about a home contents policy, it should be safely assumed that the personal circumstances relate to home contents. There should be no obligation to ask about whether the consumer should consider their need for any other form of insurance (this could trigger s992A requirements in regard to hawking).

The extent of the inquiries in relation to those personal circumstances is also problematic. Many broad risks are covered by retail general insurance policies and there may be exclusions attached to a number of them. It is not feasible in the cost effective distribution of

general insurance to have extensive discussion on each of these risk exposures. In particular, it would be prohibitively expensive to script call centres for such discussions. The consumer can be prompted to consider their particular circumstances and to read the Product Disclosure Statement (PDS) in detail. However, the insurer should not have a more extensive obligation.

With the recent experience of the floods in Queensland and Victoria, there is currently much discussion on how consumers can be helped to choose the most appropriate cover. There are suggestions that the insurer should prompt the consumer to think of flood. However, flood is only one of a number of risks such as storm surge and slippage where neither the insurer nor the consumer know or have ready access to information on the extent of specific risks faced by the consumer. It should be adequate for the insurer to suggest that the consumer consider the policy's coverage in light of their individual risks, citing perhaps several key risks that may apply.

The requirement to consider and investigate the subject matter of the advice as is reasonable in all the circumstances needs to be confined to the products which the employee/agent is authorised to handle. A comprehensive evaluation of different policy offerings is the role of an insurance broker. A consumer does not enter the office of an insurer or an insurer's agent or contact a call centre expecting advice canvassing the broad market. Rather the consumer wants to learn what policies provided by a specific insurer may be relevant to their needs.

The difficulties identified above all feed into the final requirement that the advice be appropriate to the client.

Training

The training requirements to give personal advice on general insurance products are too onerous given that the large majority of consumers only want simple level advice on the appropriateness of a particular product.

Record Keeping

The Government has provided exemptions from the need to provide a Statement of Advice (SoA) in relation to most classes of general insurance³, although, the obligation remains for personal advice in relation to consumer credit and sickness and accident insurance.

However, despite the exemption, general insurers providing personal advice in practice would maintain some form of record of the advice, particularly because of the obligations under s947D where personal advice recommends the replacement of one financial product with another financial product (see below).

Switching

Shopping around to compare general insurance policies is common. Given that a product recommendation in a personal advice situation is implicitly a recommendation to replace one financial product with another, recommending the suitability of a particular general insurance policy triggers the onerous switching requirements of s947D. This is despite consumers usually only wanting an insurer's employee/representative to give them information on the suitability of an insurer's product, not a detailed comparison.

³ See s946B(5)(c) of the Corporations Act and reg. 7.7.10 (d)-(i).

Switching requires consideration of:

- the client's existing product;
- the cost of the recommended action;
- the potential benefits that may be lost; and
- any other significant consequences of the switch.

These comparisons are onerous for general insurance. Staff are not generally trained to perform this type of analysis, nor are they trained on other providers' products (which are numerous).

Answers to questions put to PCG

Given the interest amongst Insurance Council members to once again being able to provide advice as they did pre-FSR, they have therefore been following closely the PCG discussions on access to advice.

Definition of general advice

Question 2.1 Do stakeholders consider there are any grounds for extending the coverage of general advice? If so, into what types of advice and how should the risk associated with the lower of consumer protections be addressed?

As explained above, the difficulties in providing simple personal advice are unlikely to be resolved through comprehensive ASIC guidance on the operation of scalability. The Insurance Council therefore submits that serious consideration should be given to treating personal advice on general insurance products where the advice is not comparing products of different insurers as general advice. This would mean that personal advice on general insurance products would largely consist of the advice given by insurance brokers.

The Insurance Council does not see that this would lead to any consumer detriment. The personal advice obligations have already been reduced to reflect the specific characteristics of general insurance, with Statements of Advice (SoAs) not being required for most products. The differences would be in the training required for the adviser (we note the argument made above that current training requirements in many cases are excessive in relation to personal advice on general insurance). These differences are inconsequential for the consumer who would continue to have all the protections of the Insurance Contracts Act, the other provisions of the Corporations Act, the General Insurance Industry Code of Practice and the Financial Ombudsman Service.

Under the proposed reclassification, personal advice requirements would continue to apply to situations where comparisons are being made between the products of different insurers. This is appropriate given the significance of the choices being made by the consumer.

The wider availability of general advice that the proposed reclassification would encourage would enable general insurers to give limited advice to consumers on the suitability of different policies for their specific needs. This would be a significant improvement on the current situation.

Question 2.2 As an alternative to extending the definition of general advice, do stakeholders consider there is any need to provide any further legislative clarity

around the boundary between general and personal advice (taking into account the guidance already provided in RGs 36 and 175)?

Consistent with the answer above, the Insurance Council does not see a need to clarify in legislation the distinction between general and personal advice.

Question 2.3 How would advice documentation for extended general advice differ from a statement of advice for personal advice?

As general insurance has an exemption from providing a SoA in relation to personal advice for most retail policies, there is no reason that this should change if simple personal advice were to be treated as general advice.

Non-product specific, limited advice

The PCG has discussed whether the FOFA reforms should facilitate “non-product specific, limited advice”. In the past, there have also been suggestions (for example by the Finance Industry Council of Australia) that personal advice should not cover situations where:

- the advice was strategic rather than product related; or
- it was clear that neither party intended the advice to be relied upon in taking a decision in relation to a financial product.

Without commenting on the usefulness of these suggestions for other financial services sectors, the Insurance Council considers their impact would be negligible in addressing the problems experienced with general insurance as general insurers when selling their products want to be able to talk about particular products and intend their advice to be acted upon by consumers purchasing general insurance policies.

Scalable advice

As explained above, the Insurance Council questions whether scalability can encourage general insurers to provide simple personal advice. However, we have addressed the following questions in case Government decides that scalability is the option to be pursued.

Question 1.1 Following on from the discussion at the November 2010 meeting, do stakeholders have any views on the areas where RG 200 style regulatory guidance should be provided?

If simple personal advice on general insurance products is not to be treated as general advice as proposed above, the Insurance Council submits that regulatory guidance would be very useful to demonstrate the operation of the advice definitions in the following situations:

General Insurance Scenario 1

Individual M contacts an insurer’s call centre, requests a quote for comprehensive car insurance. Noting that M’s car is old and of low value, the call centre operator mentions the possibility of third party property damage and explains the difference between it and comprehensive cover. At M’s request, the call centre operator provides a quote for the annual premiums for each product. M purchases the third party property policy.

Although presumably personal advice because the call centre operator took into account the value of M’s car and the mention of the third party property damage policy could be seen as influencing M in their purchase, the call centre operator should be taken to have fulfilled their

duty to act in the best interests of M without having to undertake a wider analysis of M's financial circumstances.

General Insurance Scenario 2

L contacts an insurer that provides personal advice and the insurer makes this known to L. L is seeking home and contents cover. In collecting information about L's circumstances, it becomes apparent to the insurer that L's house is in a flood zone. The best interests duty would require the insurer to advise L that they should consider flood cover. If the insurer does not provide flood cover, it should recommend L investigate the cover provided by other insurers.

General Insurance Scenario 3

L is seeking home and contents cover and contacts an insurer's call centre, not asking about the level of advice they provide. In providing information about the policy the insurer's staff member says "This policy does not cover flood damage. You should consider whether you need flood cover." The staff member's statements are the provision of information only and not general or personal advice.

General Insurance Scenario 4

Individual Q approaches an insurance broker, who acts as authorised representative of three general insurers. Q requests information on home insurance and the adviser, Z, provides a financial services guide that lists the insurers and the limit of Z's authority. Z proceeds to question Q on their requirements for home and contents insurance, as well as asking whether Q has any cars, boats or other property that is either insured or may be in need of insurance.

Z reviews whether any discounts are available to Q for placing all policies with a single insurer and presents Q with a range of options and premiums, explaining the difference between each one.

Z has provided personal advice, taking Q's **stated** needs into account, without analysing Q's other **financial** interests – which would not normally be disclosed by Q.

This is a common "personal advice" scenario. Application of the "best interests" duty should only require consideration of the retail client's general insurance needs.

General Insurance Scenario 5

K, a proprietor of a small business, approaches X, an authorised representative of a number of general insurers, to review the insurance needs of her small business.

X has the option of limiting his review to wholesale (business products) only, thus avoiding the onerous "best interests" duty and giving K a range of options on business interruption, ISR and liability products.

Alternately, X can provide a more holistic review of K's needs which includes retail products for sickness and accident insurance and personal or domestic property that may be partially used by the business.

These retail products would be covered by the "best interests" duty and an insurance adviser may weigh the costs of providing the additional service against the benefits (commission) and opt to deal in them without providing advice.

This is a common scenario where personal advice may be called for and a requirement for a duty of “best interest” may apply here, but should be limited to the retail client’s insurance needs.

General Insurance Scenario 6

S, a nurse, approaches an insurer for professional indemnity insurance. The insurer becomes aware that S has practised as a nurse for some years and advises S consider retroactive cover under a PI policy. The insurer helps S determine the relevant date e.g. whether that is the date they commenced practice or the date they last had claims incurred cover.

If personal advice, the insurer’s inquiries should be limited to matters directly relevant to S’s professional liabilities as a nurse, not their overall insurance needs or general financial situation.

General Insurance Scenario 7

E, an individual inquires about a home and contents policy. The insurer does not hold itself out as providing personal advice. Its home and contents policy has varying levels of excess depending on the premium. These are explained to E who takes out a policy with the largest possible excess. The insurer should be seen as providing general advice at most. There should be no obligation to enquire whether E’s choice of excess was realistic in relation to their financial situation.

Question 1.2 Treasury has received feedback that the legislation should mandate the maximum size of a statement of advice which does not provide any product recommendations. This would be a way of providing a message that scaled statements of advice are not only possible, but also necessary. Do stakeholders see merit in such a reform?

At the PCG meeting on 19 November 2010 a question was raised concerning the attitude of Professional Indemnity Insurers (PII) towards radically shorter Statements of Advice (SoAs), whether they felt their risks could be significantly increased. The Insurance Council has discussed this issue with its PII Committee. Insurance Council members support conciseness being explored as a means of improving the effectiveness of SoAs in order that consumers fully understand the advice being provided to them. However, PI insurers are also conscious of the need for financial advisers not to leave themselves exposed to allegations of negligent advice through non compliance with regulatory requirements. The Insurance Council would therefore be keen to participate in any discussions about facilitating shorter SoAs.

Question 1.3 Outside of further regulatory guidance is there anything more in the form of regulatory change that is necessary to assure industry that providing limited or scaled personal advice is not in breach of the Corporations Act?

See answers above to Questions, 2.1, 2.2 and 2.3.

COMMISSIONS

As part of the FOFA package and consultation process, the Government is consulting on whether to extend the prospective ban on conflicted remuneration structures (including commissions and volume based payments) to risk insurance (both life and general insurance) (the Review). The prospective ban will currently only apply to retail investment products including managed investments, superannuation and margin loans and will commence on 1 July 2012.

We understand that the ban only relates to commissions payable for the provision of advice (both general and personal) on retail investment products. Therefore, by extension, even if the ban is extended to general insurance, where it is sold without advice, the use of commissions (including volume payments) would still be permitted.

The Insurance Council is aware of the serious concerns that led to the Government's decision to ban conflicted remuneration structures for retail investment products. However, no evidence has been produced of commissions creating conflicts of interest in general insurance. A search of the Financial Ombudsman Service database did not reveal any relevant cases. Similarly, the Insurance Council requested its National Consumer Reference Group⁴ on 12 November 2010 to inform it of any concerns with general insurance and commissions and none have been identified to date.

At the PCG meeting of 24 January 2011, it was raised whether the instances of misselling that ASIC had prosecuted in relation to consumer credit insurance (CCI) were not proof of conflicts of interest in general insurance. However, we understand that the consumer detriment in those cases did not relate to conflicts of interest due to commissions paid in relation to advice.

In the absence of detriment to consumers, the Insurance Council strongly considers that there is no policy rationale for banning commissions in relation to the sale of general insurance.

USE OF COMMISSIONS IN GENERAL INSURANCE

The majority of Insurance Council members use intermediaries for the sale of general insurance. These include:

- Intermediaries who act on behalf of an insurer – for example
 - agents (e.g. travel agents, car dealers)
 - authorised representatives
 - distributors
- Intermediaries who usually act on behalf of an insured – for example
 - brokers (whilst brokers are generally only used in commercial markets for the sale of wholesale products, they can also be used for the sale of retail GI products)
- Other type of intermediaries – for example
 - underwriting agencies

⁴ The Group's members include Choice, the Consumer Credit Legal Centre (which includes the Insurance Law Service) and the Consumer Action Law Centre

- referrer
- financial institution []

The usage of intermediaries varies; with some general insurers using them for a small proportion of sales while others use them extensively. The use of intermediaries occurs in relation to all types of general insurance. While usage of brokers may be significant for some individual members, where an intermediary is involved in the sale of retail general insurance⁵ it will overall more likely be an agent or other type of intermediary acting on behalf of a general insurer rather than a broker.

Where the intermediary is only acting for one general insurer, which is commonly the case, there is no possibility of conflicted advice and the limited product set is known to the consumer (even if not obvious from the circumstances, it would be disclosed in the FSG). Also, as explained above, the consumer knows whether they want general insurance or not and there is very little chance of them being sold insurance that they do not need. (Different regulatory requirements are in place for the general insurance products judged to pose greater risk, consumer credit insurance and sickness and accident. See below.)

Where a customer has purchased through an agent, they typically would not pay the agent. The agent would be paid by an insurer for their sales through a fixed fee or other form of remuneration (e.g. commission). Where a commission is paid, it can be a fixed fee, percentage of premium or a contingent commission. It can also be a trailing commission where an annual fee is paid to the original agent for as long as the insured renews the cover.

In the common situation where retail general insurance is sold on a 'no advice' model, we consider that no conflict arises from the payment of a fee or commission by an insurer to an agent as it is a payment to the agent for a service, not advice. Often commissions are the most effective way of setting remuneration for intermediaries. For example, with web based sales, it would be impractical to negotiate a specific fee for each transaction. There are also few alternatives in group sale situations.

Where a customer has purchased retail insurance through a broker, they may pay a brokerage fee to the broker. This may be in addition to any commission received by a broker from an insurer. We leave it to other stakeholders to address the payment of commissions by a consumer to a broker. However, in relation to the payment of commissions by general insurers to brokers, the Insurance Council would reiterate that it is unaware of any evidence of detriment to retail consumers caused by the payment of commissions or volume payments to brokers. Similar to the situation with agents, the payments made by general insurers to brokers are for a service. Furthermore, the broker is already under a clear fiduciary duty to act in the consumer's best interests and this will be reinforced by the proposed best interest obligation on financial advisers.

DISCLOSURE OF COMMISSIONS

While general insurance products are subject to the same overall disclosure regime as other financial services, in recognition of the significantly lesser risks to general insurance consumers (as explained above in the covering letter to this submission), there are marked differences from the obligations applying to other financial products.

⁵ Retail insurance includes (as per s761G (5)(b) of the *Corporations Act 2001*): motor vehicle; home building; home contents; sickness and accident; consumer credit; travel; and personal and domestic property insurance.

Product Disclosure Statements (PDSs)

Under section 1013D(1)(e) of the Corporations Act, a commission only need to be disclosed in a PDS if it will or may impact on the amount of return generated by the financial product involved.

The Revised Explanatory Memorandum on the Financial Services Reform Bill 2001 explains:

14.86 Where the commission paid does not affect the return from a product, no disclosure is required. The amount of commission will, however, be reflected in the fees, charges paid by the consumer and disclosed under proposed paragraph 1013D(1)(d). So, for example, commission will not need to be disclosed as a stand-alone item (that is, distinct from the amounts paid by the client to buy the product) for most risk insurance and other non-investment products where the commission does not impact on the return from the product. For the most part, when a consumer purchases a risk insurance product they pay a premium in order to insure against a future risk. If and when that future risk eventuates the consumer will receive the amount for which they were insured. Even though the premium the consumer pays includes a portion that will ultimately be paid to the financial service provider as commission, the payment of the commission will not affect the amount paid if the event occurs.

In a 2003 Inquiry into the disclosure of commissions on risk products, the Parliamentary Joint Committee on Corporations and Financial Services recommended, inter alia, that the existing remuneration disclosure requirements for PDSs should be retained, i.e. there should be no disclosure of commissions for risk products in a PDS.⁶ The Government accepted this recommendation.

Financial Services Guides (FSGs)

As set out in RG 175, disclosure of all remuneration, commission and other benefits received by an adviser is required in a FSG:

“(h) information about the amount of all the remuneration, commission and other benefits that the providing entity (and other persons specified in s942B(2)(e) or 942C(2)(f)) will or reasonably expects to receive in respect of, or that is attributable to, the advice to be provided where this amount can be ascertained at the time the FSG is provided to the client (s942B(2)(e) and 942C(2)(f), regs 7.7.04(3) and 7.7.07(3));”

Statements of Advice (SoAs)

The Government has provided exemptions from the need to provide a SoA in relation to most classes of general insurance⁷. However, the obligation remains for personal advice in relation to consumer credit and sickness and accident insurance. Consequently SoAs in relation to these products need to disclose remuneration to be received by the financial adviser.

UK EXPERIENCE

The UK Financial Services Authority (FSA) recently released its Policy Statement 10/13 “Pure protection sales by retail investment firms: Remuneration transparency and the

⁶ Senate Joint Committee *Inquiry into the disclosure of commissions on risk products*, 2003, pp 58-60.

⁷ See s946B(5)(c) of the Corporations Act and reg. 7.7.10 (d)-(i).

COBS/ICOBS election”.⁸ PS10/13 was issued as part of the Retail Distribution Review (RDR) which commenced in June 2006⁹ and contains the final rules on pure protection (life insurance) products. The Insurance Council considers that the approach taken by the FSA reflects the lack of consumer detriment due to the use of commissions in relation to sales of general insurance.

The FSA in PS10/13 decided not to apply adviser charging rules to the sales of life insurance products. Where the sales of life products are associated with investment advice they are however subject to certain disclosure obligations. That is, retail investment firms must explain how they are remunerated and disclose the amount of commission received if a customer purchases such a product.

The FSA states in PS10/13 “For stand-alone sales, not associated with investment advice, our view remains that the customer’s main concern is the premium he will have to pay, rather than his adviser’s remuneration. It is only in the specific circumstances where the customer is also paying an adviser charge that we are concerned confusion could arise about what the adviser charge covers...We therefore intend to introduce increased transparency requirements for pure protection services associated with investment advice.”¹⁰

In respect of general insurance, the FSA does not appear to have even considered this to be within the scope of the RDR, let alone considered the need for advisor charging rules to apply to this market. In various reports throughout the Review the FSA made it clear that there was no intention to “read across of the RDR from the investment market to the... general insurance markets”.¹¹

In the Feedback Statement 08/6 (FS08/6) the FSA stated: “Our initial view on general insurance markets, consistent with our approach in ICOBS, is that we should focus on particular markets in considering the potential benefits from approaches developed in the RDR. It is in pure protection markets that customers are most dependent on advice...” (para 1.14, page 12) This suggests that it is only in markets where there is reliance on advice that were considered as part of the scope of RDR.

ANSWERS TO QUESTIONS POSED FOR PCG MEETING 24 JANUARY 2011

Question 2.1 Are there unique issues associated with general insurance?

As noted earlier in this submission, general insurance products are not like other financial products. General insurance products are of low risk to the consumer. They are also

⁸ Available at http://www.fsa.gov.uk/pubs/policy/ps10_13.pdf . See also: the summary document In Summary Policy Statement 10/13; and the FSA *General Insurance Newsletter November 2010* also available from the FSA website.

⁹ The Retail Distribution Review commenced in June 2006 to examine the way in which retail products are sold in the UK. It has a target date for full implementation of 31 December 2012. Over the past four years the FSA have published many discussion papers, consultation papers and reports including: Consultation Paper 10/14 *Delivering the RDR: Professionalism* (CP10/14); Policy Statement 10/13 *Pure protection sales by retail investment firms* (PS10/13); Policy Statement 10/10 *Delivering the Retail Distribution Review: Corporate pensions* (PS10/10); Consultation Paper 10/08 *Pure protection sales by retail investment firms: remuneration transparency and the COBS/ICOBS election* (CP10/08); Policy Statement 10/6 *Distribution of retail investments: Delivering the RDR* (PS10/6); Consultation Paper 09/18 *Distribution of retail investments: Delivering the RDR* (CP09/18); *RDR Interim Report (RDRIR) and Feedback Statement* (FS08/6); *RDR Interim Report (RDRIR)* in April 2008; and *RDR Discussion Paper* (DP07/01) in June 2007.

¹⁰ Ibid, PS 10/13, Para 2.9 at page 8.

¹¹ Retail Distribution Review Interim Report (RDRIR), para 2.24, p 12.

relatively straightforward; do not have an investment component; usually subject to standard terms and conditions; and of limited duration, usually 12 months.¹²

Question 2.2 Is there any evidence that general insurance commissions paid to advisers/brokers directly link to substantial client losses? If so, please provide examples

The Insurance Council is not aware of any evidence that general insurance commissions paid to advisers/brokers directly link to substantial client losses. In fact we are unaware how a loss could occur in the context of a general insurance policy irrespective of a payment of a commission to an adviser/broker. As noted above in relation to PDSs, a commission does not impact on the “return” from a general insurance product.

It should also be remembered that not only are general insurance products subject to a cooling off period, outside of this period a customer can cancel their policy at any time and most policies will provide a refund of the balance of premium.

Question 2.3 Do commissions increase the price of general insurance?

The price of general insurance must cover distribution costs such as commissions just as it must cover all other costs of providing the financial service. However, this does not result in price distortion as implied by the question. General insurance is a competitive market where consumers tend to shop around and purchase primarily on the basis of price. Consequently there is an incentive for general insurers to keep their costs as low as possible.

In a 2003 Senate Joint Committee *Inquiry into the disclosure of commissions on risk products*, the Committee acknowledged this, stating: “Unless there is evidence to show that product costs are inflated as a result of distribution through agents and brokers, the Committee accepts risk advisers’ claims that product costs will remain the same regardless of the distribution channel used”¹³

The Committee when discussing the cost efficacy of using agents and brokers versus salaried advisers noted: “...the Committee questions why risk product manufacturers would use agents and brokers to distribute their products if this was not cost effective or was more expensive than distribution through salaried advisers”¹⁴.

Question 2.4 Do commissions paid to advisers/brokers vary in size, or are they standard across the industry?

As explained above, commissions vary both in usage and size.

Question 2.5 Does a consistent approach need to be taken on both life and general insurance commissions?

While a ban on commissions in relation to one or the other industry sector but not both would be a complication in relation to insurers that sell both life and general and brokers that deal in both, these are practical issues that could be worked through.

¹² This has been reflected both in ASIC Regulatory Guides and Consultation Papers which set out these points in them. See for example RG 146: *Licensing: Training of financial product advisers*, at RG 146.38 on p 17.

¹³ See: Senate Joint Committee *Inquiry into the disclosure of commissions on risk products*, 2003, p 29. .

¹⁴ *Ibid*, pp 37-38.

Question 2.6 If a ban were to apply, would it apply in relation to personal retail advice only, or also general advice?

Putting aside the Insurance Council's position that a ban on commissions is not warranted for general insurance, if a ban were introduced, it would be difficult in practical terms to comply if the ban were not applied to both general and personal advice.

Questions 2.7 Where advice is provided, to what extent is the commission paying for the advice (rather than the distribution)? What percentage of policies are sold via personal advice.

The vast majority of retail general insurance is sold without personal advice. As such, commission payments are generally payments for distribution rather than advice.

Whilst we do not have detail on the exact percentage of policies sold via personal advice our members advise that it is a small subset of overall retail business.

Question 2.8 If commissions were to remain permissible, should the prohibition on volume payments apply to general insurance?

We do not consider that volume payments are problematic in the context of retail general insurance sales through intermediaries and employees. This is due to the features of general insurance products (low risk, no investment component) and the fact that commissions do not impact on the amount paid under any future claim.

Even where a general insurer operates a “no advice” sales model, it is commonly licensed to provide general financial advice (and often also personal advice) in order to provide a “safety net” in case advice is inadvertently provided and of course to allow for flexibility if a decision is taken to alter business models. Consequently, sales of general insurance by an insurer’s own employees are drawn within the scope of the Review where incentive programs operate to reward them for sales performance. These measures are not only usually volume based but also have a quality/compliance element to them. These incentive programs are common in the general insurance industry (as they are widespread through the general economy).

A ban on the employees of general insurers receiving commissions and volume payments would be a major change in the remuneration of this sector for no good reason. A general insurance employee deals with a particular product set and the consumer understands this. The payment of commissions and volume payments does not lead to conflicted advice. Furthermore, the consumer knows whether they want general insurance or not and there is very little chance of them being sold insurance that they do not need. In any case, there are readily accessible remedies for the sale of inappropriate general insurance under the Insurance Contracts Act and through FOS.

CONCLUSION

In summary, the Insurance Council submits that there is no basis for extending the ban on the use of commissions to sales of general insurance:

- Products are of low risk to the consumer. General insurance products are relatively straightforward; do not have an investment component; usually subject to standard terms and conditions; and of limited duration, usually 12 months.¹⁵

¹⁵ This has been reflected both in ASIC Regulatory Guides and Consultation Papers which set out these points in them. See for example RG 146: *Licensing: Training of financial product advisers*, at RG 146.38 on p 17.

- There is no evidence that the price of a general insurance product is affected by any commission paid;¹⁶
- General insurance products are largely sold on a no personal advice model so the problem of conflicted remuneration does not arise;
- In contrast to investment linked insurance products, commissions on the sale of general insurance do not impact upon the performance of the product; and
- General insurance has not experienced the conflicts of interest problems seen in other sectors.

It had been hoped that other aspects of the FOFA initiatives may encourage insurance Council members to provide more advice to consumers leading to more considered purchases of general insurance. The application of a ban on commissions and volume payments to the sale of general insurance where advice may be provided would disrupt established industry arrangements for no tangible policy outcome and would be unlikely to encourage a move to more personal advice.

¹⁶ See: Senate Joint Committee *Inquiry into the disclosure of commissions on risk products*, 2003 which considered “Unless there is evidence to show that product costs are inflated as a result of distribution through agents and brokers, the Committee accepts risk advisers’ claims that product costs will remain the same regardless of the distribution channel used” (p 29). The Committee when discussions the cost efficacy of using agents and brokers versus salaried advisers noted: “...the Committee questions why risk product manufacturers would use agents and brokers to distribute their products if this was not cost effective or was more expensive than distribution through salaried advisers” (pp 37-38).