

18 October 2018

Senate Economics Legislation Committee
PO Box 6100
Parliament House
Canberra ACT 2600

Dear Sir/Madam

Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018

The Insurance Council of Australia (the Insurance Council) welcomes the opportunity to comment on the *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018* (the Bill) and accompanying Explanatory Memorandum (the EM).

The Insurance Council supports the introduction of legislative obligations for products to be appropriately designed and distributed. However, the Insurance Council and its members are deeply concerned the obligations, as currently drafted in the Bill, will hinder rather than improve the likelihood that consumers buy insurance suitable for their needs. Furthermore, we fear that this will be accompanied by consumers having to face greater complexity when making decisions regarding the buying and renewing of policies.

The Bill's provisions in relation to design and distribution do not seem to have been designed to mesh easily with the unique characteristics of general insurance products. Unlike other financial products, the key factors in whether a general insurance product is appropriate for a consumer are the consumer's risk factors and risk appetite. Consumers have different risk factors, as well as varying appetites to self-insure and they balance these considerations against the cost of cover when making purchasing decisions. This variability, as between consumers and for any individual consumer across time and life circumstances, requires general insurers to offer a range of product offerings.

Given this, general insurance is not usually purchased "off the shelf"; in that consumers are given options to tailor policies to suit their individual needs. Key aspects of retail policies include the sum insured amount, the excess level, the level of coverage, and who is covered, are choices that consumers make. As such, home and motor policies are generally designed for mass markets of consumers, and an appropriate target market would usually be broadly characterised.

As currently drafted, there remains substantial ambiguity around how the obligations contained in the Bill are intended to apply to mass marketed retail products. The following case study outlines the uncertainties for insurers in complying with the obligations.

Case study: Defining the target market for general insurance products

Consider a home insurance policy that enables consumers to purchase either defined events only cover or defined events with accidental damage cover. Accidental damage provides wider coverage to include a range of accidental loss or damage, compared to defined events cover which provides cover following the occurrence of specific events.

An insurer, when designing their product, may consider that accidental damage cover is most suitable for families with young children, where accidental damage of assets are more likely to occur. However, this does not mean that a household with no children would not also benefit from accidental cover. This creates complexities for insurers in defining a class of consumers for products that are designed to be tailored, at the consumer's choice, with optional covers to meet specific needs.

The Insurance Council submits that the Bill requires refinement to ensure that it applies sensibly to the general insurance industry. We recommend that the Bill and EM are amended to:

- i) include an explicit objective for the product design obligation to apply in a scalable and proportionate manner; and
- ii) ensure that the distribution obligation does not interfere with efficient and effective policy renewal processes.

Recommendation 1: The product design obligation needs to be scalable

The broad characterisation of target markets for insurance products is recognised in the comparable product governance and distribution regime in the UK, where the requirement to identify a target market is accompanied by this guidance¹:

“The identification of the target market by the manufacturer should be understood as describing a group of customers sharing common characteristics at an abstract and generalised level in order to enable the manufacturer to adapt the features of the product to the needs, characteristics and objectives of that group of customers.”

A key issue for general insurers is determining how granular the design of a Target Market Determination (TMD) should be. There is no guidance in the Bill or EM around expectations for mass market products that are suitable for broad categories of consumers.

The EM² refers to a risk management approach to be taken so that the distribution obligation is scalable according to the risk associated with an inappropriate distribution of a product. While helpful in terms of making clear this intent for the distribution obligation, there is no similar guidance for the design obligation. The concept of scalability is equally important to the design obligation, where a risk management approach should result in narrower target markets for niche investment products and broader target markets for mass market insurance products.

While we understand that ASIC guidance will outline how the regime will operate in a more fulsome manner, the Insurance Council submits that the concept of scalability needs to be more firmly anchored in the legislation for both the design and distribution obligations.

¹ Financial Conduct Authority Handbook, PROD 4.2.19.

² At paragraph 1.95.

Again, the UK regime is instructive in this regard. The product governance rules for insurance products requires product manufacturers to have in place a product approval process that must be "... proportionate and appropriate to the nature of the insurance product"³. Guidance⁴ underpinning this rule further states:

"... proportionality means that the product approval process should be relatively simple for straightforward and non-complex products that are compatible with the needs and characteristics of the mass retail market. On the other hand, in the case of more complex products with a higher risk of consumer detriment more exacting measures should be required."

The Financial System Inquiry (FSI) recommended that the obligations be scalable depending on the complexity of the product and indicated that compliance should be straightforward for simple products that are likely to be suitable for most consumers. Such a fundamental principle should not be omitted from the legislation. We note that it could be included in an additional section outlining the object of the obligations in the Bill in proposed Part 7.8A Division 2; similar to section 1023A proposed for product intervention orders.

Recommendation 2: The distribution obligation should apply sensibly to policy renewals

The most common retail general insurance products are annual policies where consumers are given the option to renew at expiry. To minimise the risk of gaps in coverage, the industry has over time put in place systems and processes to make it as easy as possible for consumers to renew. Given these products are intended for mass markets, there is a greater risk of financial detriment to a broad range of consumers being inadvertently uninsured, so accessibility and useability of processes to renew are of critical importance.

Recognising the importance of efficient processes for policy renewals, the consumer protections in place under the *Insurance Contracts Act 1984* (the IC Act) for policy renewals are substantial. Insurers are required to provide a renewal letter at least 14 days before a contract of insurance expires, which contains key information about the cover offered and reconfirms details of the asset/risk to be covered as previously disclosed by the insured. Insureds are invited to update these details if there has been any change to their circumstances.

We understand that a policy decision has been made to capture insurance renewals as the issue of a new product, attracting the distribution obligation in full. The implications of capturing insurance renewals is dependent on how the obligation is interpreted and applied. If insurers are expected to ask underwriting questions again and recollect information already obtained, this would fundamentally change the way insurance policies are regulated under the IC Act and require extensive systems changes at substantial cost to the industry. If, on the other hand, the distribution obligation can be met by insurers asking consumers to disclose any change to their circumstances at renewal, as is already the case, then the compliance burden for this aspect of the new regime will be relatively minor.

A large member has estimated that the cost of overhauling their renewal processes to require the recollection of information will cost \$62 million annually. This is on top of the once off systems changes of approximately \$14 million. Ultimately, these costs will be reflected in higher premiums paid by consumers. Some members have indicated that the cost of re-collecting information via non-digital methods, including over the phone, will be too prohibitive. This may

³ Financial Conduct Authority Handbook, PROD 4.2.2.

⁴ Financial Conduct Authority Handbook, PROD 4.2.4.

mean that consumers without access to digital means of supplying information are likely to be worse-off under these obligations.

While the estimated costs to amend existing systems and processes may be high, these costs may be justified if they result in better consumer outcomes. However, the Insurance Council cannot understand how complicating existing efficient and effective processes will actually improve consumer outcomes. In fact, we are concerned that they will have the opposite and unintended effect of making insurance renewals less accessible, potentially resulting in a large number of consumers being unintentionally uninsured as a result of the introduction of friction into the renewal process (particularly for customers who will need to provide information again for multiple policies). The cost of this to the community could be significant. Requiring the unnecessary re-collection of information impedes industry efforts to use customer-centred design techniques in order to better engage consumers at renewal time; and is contrary to the objective of the legislation to mandate a customer-centric approach to the distribution of products⁵.

To the extent that the TMD remains the same and there has been no change to the consumer's circumstances, the Insurance Council submits that the distribution obligation should not be applied so that insurers must obtain information from insureds which had already been collected when the policy was first purchased. We submit that a mechanism should be included so that the customer is deemed to still be in the target market if an insurer:

- gives a description of the target market or a record of any questions previously asked to determine if the customer was in the target market;
- asks the customer to tell them if anything has change; and
- the customer does not contact the insurer to tell them that anything has changed.

This is similar to one of the methods that can be used by an insurer to comply with the renewal duty of disclosure under s21B of the Insurance Contracts Act.

If you have any questions or comments in relation to our submission, please contact John Anning, the Insurance Council's General Manager Policy, Regulation Directorate, on (02) 9253 5121 or janning@insurancecouncil.com.au.

Yours sincerely



Robert Whelan
Executive Director & CEO

⁵ At paragraph 1.5 of the EM.