INSURANCE COUNCIL OF AUSTRALIA

15 August 2018

Manager
Consumer and Corporations Policy Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: ProductRegulation@treasury.gov.au

Dear Sir/Madam

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

The Insurance Council of Australia (the Insurance Council) appreciates the opportunity to comment on the revised exposure draft *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Power) Bill 2018* (the draft Bill). The Insurance Council remains supportive of legislative obligations to ensure that financial products are appropriately designed and distributed. We are keen to continue to work with Treasury to ensure that the proposed legislative obligations are able to be applied in an effective and appropriate manner to the general insurance industry.

While the Insurance Council is pleased that the draft Bill has been amended to take into account many of the issues raised in our submission (dated 2 February 2018), there are some remaining issues that will impede the proposed regime from being applied in an appropriate and proportionate way to general insurance. While we understand that a principles-based approach is necessary for legislative obligations which will apply across the broad range of financial products, it is still unclear how substantial aspects of the draft Bill will apply in practice to general insurance.

The Insurance Council strongly submits that there needs to be greater clarity in the Bill around how the design and distribution obligations are intended to operate generally for mass market products and apply to insurance policy renewals in particular. Without practicable outcomes on these issues, the Insurance Council and its members are concerned that the obligations will hinder rather than increase the likelihood that consumers buy insurance suitable to their needs as they face more, and unnecessarily, complex purchasing processes.

We also address other key issues that require clarification or amendment in the **Attachment** to this submission.

Scalability and mass market insurance products

As noted in the Insurance Council's previous submission, considerations around what a target market should look like for common retail general insurance products, such as home and motor insurance, are necessarily different to most other financial products. 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, including the sum

Insurance Council of Australia Limited ABN 50 005 617 318
PO Box R1832 Royal Exchange NSW Australia 1225
t +61 2 9253 5100 f +61 2 9253 5111
www.insurancecouncil.com.au

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. 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 guidance[1]:

> "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. While we understand that Treasury expects a TMD, for example for a motor vehicle insurance product to be more detailed that just "anyone with an insurable interest in a motor vehicle", there is no guidance in the draft Bill or explanatory memorandum (EM) around expectations for mass market products that are suitable for broad categories of consumers.

The draft EM[2] 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 Treasury's intention is to provide sufficient flexibility in the legislation to enable issuers and distributors to determine how they should satisfy the obligations, supported by guidance to be developed by the Australian Securities and Investments Commission (ASIC), 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. Again, the Treasury may find the UK regime 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]. Guidance[4] 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 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

---

[1] Financial Conduct Authority Handbook, PROD 4.2.19.
[2] At paragraph 1.89.
[3] Financial Conduct Authority Handbook, PROD 4.2.2.
[4] Financial Conduct Authority Handbook, PROD 4.2.4.

likely to be suitable for most consumers. Such a fundamental principle should not be omitted from the legislation. We note that such a principle could be reflected in an additional section outlining the object of the obligations; similar to section 1023A proposed for product intervention orders.

We understand Treasury's intent is for the legislation to be supplemented by ASIC guidance. It is imperative for such guidance to be sector-specific, and provide product-specific examples that are relevant to the general insurance industry. Guidance at a higher cross-sector level is unlikely to be helpful in providing the industry with adequate direction on how the obligations should apply in practice.

We also note, given the importance of guidance in clarifying how key aspects of the obligations will apply, it is critical that ASIC commences consultation as soon as possible. If consultation on the guidance does not commence until the legislation receives royal assent, this will substantially deplete the transition period for industry to make the required systems changes.

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 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 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 burden of this on the community has the potential to be significant. Requiring the unnecessary re-collection of information impedes industry efforts of employing customer-centred design techniques to better engage consumers at renewal time; and contrary to the objective of the legislation to mandate a customer-centric approach to the distribution of products[5].

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.

While we understand Treasury may be reluctant to incorporate sector-specific provisions into the legislation, we note that there are already many provisions in the Corporations Act which are specific to insurance.

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 [redacted] or [redacted].

Yours sincerely

Robert Whelan
Executive Director & CEO

[5] At paragraph 1.5 of the draft EM.

INSURANCE COUNCIL OF AUSTRALIA

ATTACHMENT

Issues for General Insurance – *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Power) Bill 2018*

	Issue	Description	Recommendation
Design obligation			
1.	It is unclear how s.994B(8) should be interpreted.	Section 994B(8) states: *A TMD for a financial product must be such that it would be reasonable to conclude that, if an issue, or a regulated sale, of the product were to occur:* *(a) In accordance with the distribution conditions to a retail client – it would be likely that the retail client is in the target market; and* (b) *To a retail client in the target market – it would likely be consistent with the likely objectives, financial situation and needs of the retail client.*	The (b) limb of the reasonable test requires reconsideration. Our understanding is that Treasury's intention is not for the TMD to result in the objectives, financial situation and needs of "*the* retail client" (i.e. the individual) being met. This would be an impossible obligation to fulfil. The objective can only reasonably be that the retail client buying the product at least has the identified objectives and needs of the product's target market.
2.	The period is too short before the prohibition is required not to engage in distribution conduct where TMD no longer appropriate.	Under section 994C(3)(b), where a TMD may no longer be appropriate, distribution conduct must cease no later than 10 business days after a review trigger.	10 business days may not, in all instances, be sufficient for an issuer to actually cease the issuance of products. Systems are currently not configured to be able to cease issuance immediately. While issuers should have an obligation to notify distributors to cease conduct within 10 business days, the legislation should be amended to

			require distribution conduct to cease within 15 days.
3.	Publication of the TMD in the PDS	Under existing section 1013E of the Corporations Act, there is a general obligation for issuers to include information in the PDS that might influence a decision to acquire. This may require any changes to the TMD to also be reflected in the PDS.	The disclosure obligations should be amended so it is clear that the TMD does not have to be included in the PDS.
Distribution obligation			
4.	Obligation to collect distribution information requires clarity	The draft legislation requires specific distribution information to be collected. Where insurers issue directly to the market, it is clear that they are obliged to meet this information requirement. However, where a third party distributor deals in a product, the draft legislation could be read to require both the insurer and third party distributor to collect and retain this information.	The requirement to collect and retain distribution information should attach to the distributor who holds the customer relationship at transaction. This would be the insurer for direct sales, and third party distributors for all other sales.
5.	Definition of retail product distribution conduct	The legislation has been amended to apply the distribution obligation to "retail product distribution conduct". However the definition does not only include "dealing in the product" but also "giving a Product Disclosure Statement for the product to a retail client".	Treasury, at the 8 August consultation session, confirmed that the giving of a PDS may trigger the distribution obligation. Distributors may not have the information required to assess whether someone is within the TMD at the point where a PDS is provided. This obligation is particularly problematic for mass retail products where the PDS is publicly available on a website.

			Given the distribution obligation will be triggered when a product is issued, it is unclear what additional benefit would be derived from an additional trigger of providing a PDS. The definition of retail product distribution conduct should not include the provision of a PDS.
6.	Distribution obligation may trigger the provision of general advice	Schedule 1, section 4 of the draft Bill proposes inserting after subsection 766B(3): *(3A) However, the acts of asking for information solely to determine whether a person is in a target market (as defined in subsection 994A91)) for a financial product, and of informing the person of the result of that determination, do not, of themselves, constitute personal advice.* While this clarifies that information collected to meet the distribution obligation will not trigger the personal advice rules, satisfying the distribution obligation may still trigger the provision of general advice. We note some general insurance products are distributed on a no-advice model.	The proposed subsection 766B(3) should be amended to expressly provide that information collected to meet the distribution obligation does not constitute personal or general advice.
7.	Personal advice exemption require clarity	Personal advice is proposed to be carved out through the definition of "excluded dealing". However, as currently defined, it is unclear what happens when a person has been given information about two or more products and received personal advice recommending product A, but they wish to purchase product B despite the personal advice.	The exemption should apply regardless of whether the personal advice recommendation is actually implemented.

Scope and commencement of PDDO			
8.	Clarity required for package products that are only partly retail	Some general insurance package policies have both wholesale and retail components of cover. It is unclear in the draft Bill whether the obligations apply only to the retail component of the package or the entire package. For example, where a Farm Pack contains home and contents and domestic motor insurance as well as non-retail products such as Public and Products Liability and Farm Property cover. In most instances, all retail and wholesale covers will practically be contained in a single PDS, but the PDS content obligations technically only apply to the retail client covers not the wholesale client covers.	The legislation should prescribe that the obligations apply only to products that are "wholly a retail product". If not addressed, insurers will likely have to separate the retail covers from the wholesale covers, requiring extensive and costly modifications to systems. In addition, purchasing the component covers separately is likely to increase the cost for consumers.
9.	Medical indemnity insurance	Under regulation 7.1.17A of the *Corporations Regulations 2001*, the definition of a retail general insurance product is expanded to include medical indemnity insurance. All other professional indemnity products, including those provided to other healthcare practitioners such as dentists and optometrists, are not defined similarly as retail products. Medical indemnity was included as a retail product following the numerous reforms in 2002 to stabilise the medical indemnity insurance market.	In the regulations, as enabled in s.993DL(b) of the draft Bill, there should be a clear exclusion for medical indemnity insurance.

		Medical indemnity should not be considered to be a retail product for the purposes of the design and distribution obligations, and the ASIC intervention power. Imposing product design and distribution obligations would unnecessarily duplicate and complicate the mandated minimum medical indemnity product features, including a prescribed minimum cover amount, under the Medical Indemnity (Prudential Supervision and Product Standard) Act 2003. We note that medical indemnity is subject to a number of government funded schemes, which oblige medical indemnity insurers to offer cover (known as universal cover) to any medical practitioner within agreed state-based jurisdictions. The concept of universal cover is incompatible with an obligation to limit distribution in any way.	
10.	It is ambiguous whether strata insurance would be caught by the PDDO	In some circumstances, insurers take a conservative compliance approach by providing PDSs for strata insurance, although it may not be required.	In the regulations, as enabled in s.993DL(b) of the draft Bill, there should be a clear exclusion for strata insurance.
Other issues			
11.	The benefit to consumers of requiring promotional material to refer to the target market is questionable	The draft law amends existing s.1018A to require an advertisement or published statement in relation to the product to describe the target market or specify where the description is available.	The requirement for promotional material to refer to the target market should be removed.

		Given the target market for most general insurance products will include a broad range of consumers, we question the benefit to consumers of this additional disclosure requirement.	
12.	Reasonable test requires clarification	There are a number of requirements for insurers (and regulated persons) to act reasonably (e.g. the obligation in section 994E(1) to take reasonable steps that will, or are reasonably likely to, result in retail product distribution conduct in relation to the product being consistent with the target market determination). It is unclear if the test is to be applied objectively (i.e. from the perspective of a reasonable insurer/regulated person) or subjectively (i.e. from the perspective of an actual insurer).	This should be clarified in the legislation or EM.