INSURANCE COUNCIL OF AUSTRALIA

14 October 2019

Ms Ruth Moore
Manager
Financial Services Reform Taskforce
The Treasury
Langton Crescent
PARKES ACT 2600

By email: ProductRegulation@treasury.gov.au

Dear Ms Moore

CORPORATIONS AMENDMENT (DESIGN AND DISTRIBUTION OBLIGATIONS AND PRODUCT INTERVENTION POWERS) REGULATIONS 2019

The Insurance Council of Australia[1] (*Insurance Council*) appreciates the opportunity to comment on the exposure draft version of the *Corporations Amendment (Design and Distribution Obligations and Product Intervention Powers) Regulations 2019*. This submission addresses the treatment of general insurance renewals in the Product Design and Distribution Obligation (*PDDO*) Regulations (*Regulations*) under the *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Act 2019*.

Insurance renewals

The industry continues to support the aim of the PDDO Regulations to improve consumer outcomes by "…ensuring that financial service providers have a customer-centric approach to making *initial* offerings of products to consumers…" (Emphasis added).[2] We also appreciate from our previous discussions that the policy intent is that only reasonable steps should be taken to comply with the PDDO Regulations.

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[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 2013 Australian Prudential Regulation Authority statistics show that the private sector insurance industry generates gross written premium of $40.4 billion per annum and has total assets of $112.6 billion. The industry employs approximately 60,000 people and on average pays out about $92.5 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).

[2] Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2018, Explanatory Memorandum, paragraph 1.7.

There is however currently uncertainty about whether this objective is achieved through the current drafting. As renewal of an insurance policy is treated as a reissuing of the policy, the insurer must verify that the policyholder remains within the Target Market Determination (TMD). The current regime can be interpreted as requiring active and explicit confirmation by policyholders at renewal each year that their personal circumstances had not changed. The insurer would be obliged to ask its underwriting questions again and recollect information previously obtained.

This could lead to significant consumer detriment given that a large proportion of policyholders will not be contactable by telephone or web portals at any given point in time. Unsuspecting policyholders will inadvertently lose their coverage if they are unable to make active acknowledgments at renewal. Severe financial detriment could arise particularly for policyholders caught up in natural disasters.

This will be a particularly serious issue in relation to automatic renewals (as opposed to those where a customer needs to contact the insurer to initiate renewal). Automatic renewal arrangements protect consumers from unintentionally losing coverage. Given that documents are provided well before the renewal date, policyholders will also have an opportunity to shop around to ensure that they are obtaining the best value cover that meets their needs.

We are also concerned about the large compliance cost impact that would arise from requiring active acknowledgments, particularly when there are ongoing concerns about the affordability of premiums for lower income households. Our concerns including an estimate of the compliance cost impact, and the systems changes required, are outlined in *Additional Information*.

Recommendation: That the Government provide certainty to the industry through new Regulations which stipulate that the PDDO obligations can be met by general insurers asking policyholders to disclose any change to their circumstances at renewal each year. Policyholders would be deemed to 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 policyholder was in the Target Market;
- asks the policyholder to tell them if anything has changed;
- where required, provide a warning of limits to cover and examples of people not in the target market; and
- the policyholder does not contact the insurer to tell them anything has changed.

Products issued before commencement

A TMD must be prepared for policies in force and which remain in force after the commencement of the regime. This would capture policies purchased by consumers prior to commencement, and which are no longer issued by the insurer.

Despite the product no longer being offered by the insurer, the need to have a TMD may be technically triggered under the provisions when:

- the insurer or regulated person gives general advice on the product, for example, when a consumer wishes to vary their existing policy; or

- the consumer requests changes to their policy, for example adding new cover.

In some circumstances, a small number of policies remain in force for products that are no longer issued to consumers. Requiring a TMD to be developed for policies no longer issued would create an unnecessary compliance burden, and in our view was not intended to be captured by the obligations.

Recommendation: That general insurance products which are no longer issued following commencement of the reforms be exempted by regulation from the PDDO regime.

Credit facilities not issued in the course of a business of providing credit

The regulations exempt a credit facility that is not issued in the course of a business which is wholly or partly a business of providing credit.

Greater certainty would be appreciated regarding how this exemption applies in relation to instalment premium arrangements. The current draft Regulations can be read to suggest that the provision of credit by way of instalment premium options in a general insurance policy would not fall within the exemption on the basis that is only incidental and insufficient to qualify an insurer as being "partly a business of providing credit".

However, the Explanatory Statement provides that an exemption should apply to credit which is merely incidental to the operation of a non-credit business (with emphasis added):

> The regulations exempt a credit facility that is not issued in the course of is wholly or partly a business of providing credit. This is wholly or partly a business of providing credit. This excludes from the operation of the DDO regime individuals that provide credit for social or family reasons (for example, a parent that lends money to a child) and *credit that is merely incidental to the operation of a non-credit business.*

The Insurance Council submits that the better argument is that instalment premium arrangements fall within this category and should be exempt.

Recommendation: That the PDDO rules are amended to give certainty that instalment premium options are exempt from PDDO obligations.

Credit provided for business purposes

The Explanatory Statement provides:

> The regulations exclude from the scope of the DDO a credit facility (within the meaning of the Australian Securities and Investments Commission Regulations 2001) under the terms of which the credit is, or must be, applied wholly or predominantly for business purposes. This means that business loans and other credit provided for business purposes are outside of the scope of the DDO.

Further clarification would be appreciated (possibly with examples in the Explanatory Statement) regarding the scope of "other credit provided for business purposes".

Recommendation: That in clarifying the extent of the exemption for "other credit provided for business purposes", the Explanatory Statement should give examples relevant to the general insurance industry such as premium funding and instalment premium arrangements used for businesses.

Medical indemnity insurance exemption

The Insurance Council is pleased that our earlier submissions seeking an exemption for medical indemnity insurance from the proposed product design and distribution obligations have been addressed in the draft Regulations.

Our position continues to be that an exemption for medical indemnity is appropriate, as applying these obligations will unnecessarily complicate the mandated minimum medical indemnity product features under the *Medical Indemnity (Prudential Supervision and Product Standard) Act 2003*. The exemption for medical indemnity will ensure that they are treated the same way as all other professional indemnity insurance products, which will not be subject to the product design and distribution obligations.

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 telephone: 02 9253 5121 or email: janning@insurancecouncil.com.au.

Yours sincerely

Robert Whelan
Executive Director and CEO

INSURANCE COUNCIL OF AUSTRALIA

ADDITIONAL INFORMATION

Key features of the new PDDO regime

The PDDO regime imposes a broad set of new requirements for general insurers including to:

- make a Target Market Determination (*TMD*) in relation to general insurance products that require disclosure;
- make the TMD available free of charge to the public;
- develop a plan for reviewing TMDs and abide by that plan; and.
- specify distribution information that distributors must collect, keep and provide back to the general insurer. Reasonable steps must be taken so that distribution is consistent with the most recent TMDs.

In relation to general insurance renewals, we note that unless a policyholder's circumstances or the TMD has changed, the appropriateness of a product should still be the same at renewal as when the policyholder first purchased the policy.

Current renewal processes

Many insurers that issue retail insurance that is renewable (i.e. car, home, contents, personal effects, sickness etc.) agree with insureds on an automatic renewal process. For customers that pay by instalment, a renewal invitation is given to them at least 14 days prior to renewal (usually longer), attaching the schedule for the new period of insurance. Unless otherwise advised by the customer, the insurer offers renewal and will automatically renew the policy on the terms offered. There are real benefits in this process for insureds in terms of cost savings and a reduced risk of being left uninsured.

For renewable eligible contracts (i.e. home, motor, sickness and accident etc. sold to individuals), where the insurer seeks to rely on the duty of disclosure at renewal, the insurer can, prior to renewing the policy, provide the customer with a copy of the matters previously disclosed and ask them to disclose any changes or confirm that there have been no changes. If the customer does not respond, they are taken to have advised the insurer that there has been no change to the relevant matters (see s21B of the Insurance Contracts Act).

Compliance cost estimates

Requiring active acknowledgments would represent a fundamental change to insurers' business models and would require large systems changes. While it is difficult to extrapolate across the general industry given different cost structures:

- Large insurers have estimated that the recollection of information would cost up to $80 million each annually – with one off system set up changes of approximately $14 million each.
- A mid-tier insurer has estimated $18 million in annual costs – with one off systems changes of approximately $20 million each.
- A smaller specialist insurer has estimated $5.5 million in annual costs – this would represent a 1200% increase in customer service costs associated with the renewal process.

Increased compliance costs will ultimately be reflected in higher premiums, which compounds ongoing concerns about the affordability of insurance premiums for lower income households. We are also concerned that the compliance cost increase will impact smaller insurers the hardest. Consumers will be left worse off as a result.

System changes to comply with an active acknowledgment requirement

Members have provided an early indicative list of systems changes which would be needed if an active acknowledgment requirement would apply to general insurance renewals, in relation to customers who have not opted out of automatic renewal:

- System changes to facilitate an online website or portal where customers could easily complete the TMD questions.[3]
- System changes to capture Yes/No for active acknowledgment received, plus to facilitate reporting lists and timeframes for follow up contacts (calls / emails) for customers that insurers do not hear back from.
- System changes to stop policies automatically renewing unless an active acknowledgment has been received.
- Finance system changes so that premiums aren't deducted as and from the renewal date for customers for whom we have not received the active acknowledgment.
- Changes to all collateral items to reflect that automatic renewal of the policy is contingent upon receiving the active acknowledgment. This would extend to quote tools, direct debit acknowledgments, letters, scripts, and PDSs.
- Development of new collateral items and scripts etc. for follow up of customers who have not responded.
- Changes to quality assurance / monitoring systems, to facilitate review of active acknowledgment communications with customers.

Existing consumer protections for renewals

Consumer protections under the Insurance Contracts Act for renewals are already substantial. Insurers are required to provide a renewal letter at least 14 days before the contract expires, which contains key information about the cover offered and reconfirms details of the asset/risk to be covered as previously disclosed by the policyholder. Policyholders are invited to update these details if there has been any change to their circumstances. These protections ensure that policyholders are fully informed at each renewal, but do not make the process so cumbersome that policyholders cannot easily renew their policy.

[3] Whilst we acknowledge that this infrastructure would not be (legally) essential, the resourcing costs and administrative burden of having an entirely manual / paper based process to ask the TMD and then assess the answers (e.g. requiring customers to answer the TMD questions by phone or email) would be prohibitive.