Insurance Council
of Australia

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Dear Mr Spear

DEFERRED SALES MODEL – EXPOSURE DRAFT REGULATIONS EXEMPTIONS

The Insurance Council of Australia (**Insurance Council**) welcomes the opportunity to comment on the exposure draft *Australian Securities and Investments Commission Amendment (Deferred Sales Model Exemptions) Regulations 2001* (**Regulations**), which will exempt several classes of add-on insurance products from the Deferred Sales Model (**DSM**) requirements in sections 12DQ, 12DR and 12DS of the *ASIC Act 2001*.

The Insurance Council is the representative body of the general insurance industry in Australia and represents approximately 95 percent of private sector general insurers. As a foundational component of the Australian economy the general insurance industry employs approximately 60,000 people, generates gross written premium of $53.9 billion per annum and on average pays out $166.2 million in claims each working day ($41.5 billion per year).

The Insurance Council supports the scope of exemptions set out in the Regulations, however, submits that several of them would benefit from changes to improve the clarity of their application and/or to avoid adverse consequences. Those relate to the following:

- Business-related add-on insurance product (regulation 12L);
- Add-on home and contents insurance product (regulation 12E);
- Add-on vessel insurance product (regulation 12H);
- Add-on transport and delivery insurance product (regulation 12J); and
- Add-on insurance products with additional benefits (regulation 12H and others).

The Insurance Council also submits that an additional exemption is warranted, in relation to add-on livestock insurance.

The Insurance Council's submissions in relation to these matters are set out in sections 1 to 5 of this letter below.

1. Business-related add-on insurance product (regulation 12L)

Regulation 12L defines a "*business-related add-on insurance product*", for the purpose of exempting that class of product from the DSM, as a product:

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- that is offered or sold to a consumer in connection with the consumer acquiring another product or service "*in the course of carrying on a business*"; and
- for which the premium payable "*exceeds $40,000*".

The Insurance Council supports the exemption of business-related add-on insurance products, however submits that:

- the definition would have the effect of excluding only a fairly small group of those products from the DSM, given the proposed $40,000 threshold; and
- the application of the DSM to insurance sold to wholesale clients carrying on a business in add-on insurance situations below that threshold is not warranted and likely to have adverse consequences.

Rationale

The Insurance Council has previously made submissions on this issue in its confidential submission regarding the DSM of 15 February 2021 and its further submission regarding wholesale clients and transit insurance of 1 March 2021. It remains of the view that:

- the policy rationale for the DSM is to protect everyday consumers from pressure-selling of add-on insurance products, and not to focus on business-related insurance products that are provided to business as a wholesale client;
- extending the exemption of business-related insurance products to all those products provided to business as a wholesale client would better align the application of the DSM with that of the anti-hawking and other consumer protections in the Corporations Act; and
- not doing so is likely to result in adverse outcomes.

While the Insurance Council acknowledges and supports the recommendation of Commissioner Hayne, in the Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, that Treasury should develop "*an industry-wide deferred sales model*", the focus of that recommendation was plainly on insurance products sold to individual consumers rather than to persons carrying on a business. He refers, for instance, to the need to apply the model not only to insurance sold in connection with credit cards and personal loans, as the Code of Banking Practice required at the time, but also to home loans (see section 4.1.3 on page 288). He makes no mention of concerns regarding the sale of add-on insurance to persons carrying on a business and, in our opinion, the recommendation should not be interpreted as extending to those persons.

$40,000 Threshold

The proposal to include a $40,000 premium threshold in regulation 12L will operate as a very high bar. Most categories of business insurance are normally issued for a premium far less than that amount. In practice, it would be rare for any business insurance policies other than large property and financial lines insurance covers to exceed the threshold.

For instance, members of the Insurance Council have provided the following median premiums for a range of business insurance products sold to small businesses (less than 20 employees):

Class of Insurance	Median Premium
Professional indemnity	[redacted]
Marine	[redacted]
Machinery breakdown	[redacted]
General property	[redacted]
Commercial motor	[redacted]
Glass	[redacted]
Business pack	[redacted]
Plant and machinery	[redacted]
Liability (through group purchasing bodies)	[redacted]

It follows that, based on the current regulation 12L, most business products will be subject to the DSM where they are offered or sold as add-on insurance.

The Insurance Council provided examples of business products that could be subject to the DSM in Attachment A to the Insurance Council's submission of 1 March 2021. Those products are repeated below, with three additions, for ease of reference:

Class of Insurance	Example of add-on situation
Trade Credit insurance	Online platform for commercial sales offers trade credit insurance to guarantee the credit transaction.
Liability insurance	Group purchasing bodies offer the product as a benefit to members on payment of premium.
Aviation insurance	Aircraft brokers may offer to arrange insurance in connection with the sale of aircraft.
Livestock insurance	Sellers of livestock may offer insurance in connection with the sale of livestock, prior to the new owner taking on the risk of the animals.
Plant & Machinery insurance	Insurance may be offered in the course of machinery sales to commercial customers.
Marine insurance (not goods in transit and marine pleasurecraft)	Marine brokers may offer insurance in connection with the commercial sales of boats.
Fleet and heavy haulage insurance	Insurance may be offered in the course of heavy vehicle sales to commercial customers.
Accidental damage insurance	Insurance may be offered as an add-on to sales of computers and electronic devices to businesses and educational institutions. These are often bulk purchases.
Professional indemnity insurance	Acquired by a business from a professional membership body in connection with its licensing or membership.
Commercial strata insurance	Acquired by a body corporate from a strata manager in connection with its management of the body corporate's affairs (which means that mixed-use strata insurance may be caught by the DSM).

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Class of Insurance	Example of add-on situation
Industrial Special Risks (ISR) insurance	Insurance may be offered as an add-on in connection with a business loan.

These products would also commonly have premiums significantly under $40,000 and so would need to have the DSM applied to them where that is the case.

Application of the DSM

The application of the DSM to such a broad range of business insurance products will bring some challenges.

As a practical matter, the use of a premium threshold means that insurers will need to identify all business insurance products which are sold in add-on insurance situations where those products could have a premium of $40,000 or below, and then put in place DSM arrangements for use with those products as required. As a result, even high value business insurance products could need a DSM process to be built for them, to cover those situations where the premium is $40,000 or below.

As a second point, the premium for the business insurance product will not normally be known (at least with any precision) at the time that a decision needs to be made whether to apply the DSM given that insurers would not ask underwriting questions during the pre-deferral period. In order to avoid a breach, insurers would need to carry out a best-estimate of the potential premium prior to that point and, in the event of uncertainty regarding whether that will exceed $40,000, apply the DSM in any case. This would inevitably result in the DSM being applied to insurance products which ultimately have premiums over $40,000.

Adverse outcomes

It is submitted that retention of regulation 12L in its current form, so that business insurance with a premium of $40,000 or less may be subject to the DSM, could have the following adverse outcomes:

- Insurers will need to promptly identify which of their business insurance sold in an add-on insurance situation could have a premium of $40,000 or less and implement a DSM process in relation to that insurance.
- Businesses would be unable to continue to purchase that business insurance in an add-on insurance situation without the DSM first being applied. Where the business requires the insurance cover immediately or promptly, it would need to either wait for the deferral period to come to an end or seek to obtain the insurance in a standalone market.
- The combination of these first two factors may dissuade insurers from continuing to distribute business products in some add-on insurance situations, which in turn lessens competition.

Proposal

The Insurance Council remains of the view that the DSM should not apply to insurance products provided to any persons carrying on a business as wholesale clients. It is submitted that this would not conflict in any way with the achievement of Commissioner Hayne's recommendation. The DSM would continue to apply to:

- all add-on insurance products sold to individuals (ie. not just limited to those set out in section 761G(5) of the *Corporations Act*); and

- all add-on insurance products sold to business as a retail client (ie. products set out in section 761G(5) for use in connection with a small business).

This approach would still require Insurance Council members to have regard to whether a business is a "*small business*" (as defined in section 761G(12)) for some products, however members already have systems in place to meet that requirement with respect to retail client obligations generally.

On that basis, the Insurance Council submits that regulation 12L(b) should be amended to the following effect:

> *(b) the add-on insurance product is not provided to the consumer as a retail client.*

If Treasury is of the view that section 12DX(1) of the *ASIC Act 2001* does not empower it to specify a "*class of add-on insurance products*" in this way, it is submitted that it could achieve the same outcome by:

- deleting regulation 12L(b); and
- applying a condition, pursuant to section 12DX(2) of the *ASIC Act 2001*, to the following effect:

> *the exemption of business-related add-on insurance products in regulation 12B(1)(i) does not apply to an add-on insurance product that is provided to the consumer as a retail client.*

Alternative Proposal

If Treasury does not accept that submission, it is submitted that the following changes should be made:

- Regulation 12L(b) should be amended by replacing "*$40,000*" with a materially lower premium threshold, so as reduce the scope for the DSM to be applied to business insurance. For the reasons set out above, this option would result in a DSM still needing to be applied in a range of inappropriate situations, however the adverse outcomes associated with that will be reduced if the threshold is lower. Having regard to the example premiums referred to above, it is submitted that $5,000 would be an appropriate figure.
- Additional exemptions should be established for those business insurance products for which the DSM is most inappropriate, including those products set out on pages 3 and 4 above. We acknowledge that the establishment of clear definitions for those products will be difficult to achieve within the timeframe remaining before the commencement of the Regulations. It is also a less satisfactory approach given that product developments in the future may necessitate changes be made to the definitions. However, if Treasury does not accept our principal proposal above, it is submitted that it would go some way to avoiding adverse outcomes in relation to business insurance products and, with that in mind, the Insurance Council would be pleased to assist with expediting the preparation of appropriate definitions.

2. Add-on home and contents insurance product (regulation 12E)

The Insurance Council welcomes the exemption for home and contents insurance as set out in regulation 12E. However, while the regulation will exempt an insurance product that provides cover for both a home building and the designated contents of that building, in our opinion its current wording does not clearly exempt a product that only provides cover for the contents of a home building.

Insurance for home contents only (without home building cover) is commonly purchased by owner-occupiers and tenants of strata units, to cover the contents of their unit. That insurance normally covers not only movable contents in the strata unit but also fixtures such as cupboards, floor covering, blinds and built-in furniture (ie. which are not covered by the strata body corporate's insurance cover). It does not, however, provide any cover for the destruction of or damage to a building used principally and primarily as a place of residence, and so will not be exempt from the DSM under regulation 12E.

The Insurance Council included detailed submissions on its rationale for seeking an exemption from the DSM for both home building and home contents insurance in its confidential submission of 15 February 2021 (from page 19). Those are repeated here.

Proposal

The Insurance Council proposes that contents insurance products should be exempted from the DSM on the same basis as for home and contents insurance products and that this could be done simply by:

- replacing the word "*and*" at the end of regulation 12E(1)(b)(iv) with "*and/or*"; and
- amending regulation 12E(1)(c) to read "*the designated contents of a building described in subparagraph (a) and/or any out-building described in subparagraph (b)(i)*".

This change would have the result of exempting an insurance product that provides cover only for the destruction of or damage to designated contents in a residential building from the DSM in the same way as for a home and contents insurance product.

3. Add-on vessel insurance product (regulation 12H)

The Insurance Council welcomes the exemption for boat insurance as set out in regulation 12C. However, unlike the exemption for limited motor vehicle insurance, as set out in regulation 12H, the exemption for boat insurance applies only to comprehensive policies (ie. being policies that provide all of the cover elements set out in regulation 12C). It follows that consumers that are offered third party property damage boat insurance in an add-on insurance situation, such as through a boat dealership, would be subject to the DSM.

Third party property damage boat insurance can be a valuable offering to consumers with old or low value boats. Importantly, it provides cover for cover for legal liability to pay compensation as a result of personal injury to another party.

On the same basis as for motor vehicle third-party property (**TPP**) or third-party property, fire and theft (**TPFT**), it is submitted that this class of insurance product is well known to consumers in the boat market, and does not warrant application of the DSM.

We note that without an exemption for TPP and TPFT boat insurance, commercial marine policies may inadvertently be caught by the regime. This is because commercial marine policies are typically not written on a "*comprehensive*" basis; rather, most policies are issued on hull risks only with third party liability issued separately.

Proposal

The Insurance Council proposes that:

- the references in regulations 12A, 12B(1)(f), 12H to "*add-on limited motor vehicle insurance product*" be replaced with "*add-on limited motor vehicle or vessel insurance product*"; and
- the references in regulation 12H to "*motor vehicle*" be replaced with "*designated vehicle or vessels*".

4. Add-on transport and delivery insurance product (regulation 12J)

Regulation 12J defines an "*add-on transport and delivery insurance product*" as one that provides cover in respect of the loss of or damage to matters or things "*in the course of the transport or delivery of the matter or thing*".

It is common for transit insurance products of this class to also provide cover for the temporary storage of the goods the subject of the transport or delivery. That reflects the fact that those goods are often placed in temporary storage after they have been collected from their point or origin and/or prior to being delivered to their destination. The insurance commonly covers risks associated with that temporary storage, including with respect to damage and theft.

The Insurance Council welcomes the exemption on add-on transport and delivery insurance, however our members are concerned that transit insurance which includes cover for temporary storage may not fall within the terms of the exemption.

Proposal

The Insurance Council proposes that regulation 12J be amended as per below:

> *An add-on transport and delivery insurance product is an add-on insurance product that provides insurance cover (whether or not the cover is restricted) in respect of the loss of, or damage to, any matter or thing in the course of the transport or delivery of the matter or thing, <u>including where that product provides insurance cover for any temporary storage during the transport or delivery</u>.*

5. Add-on insurance products with additional covers (regulation 12H and others)

Several of the add-on insurance products exempted in the Regulations are defined in a way which could significantly restrict their application. The most pronounced of those is the exemption for "*add-on limited motor vehicle insurance product*".

Regulation 12H

Regulation 12H defines an "*add-on limited motor vehicle insurance product*", for the purpose of exempting that class of product from the DSM, by reference to cover for either or both of the following:

- loss of, or damage to, property of another person resulting from an accident in which the motor vehicle is involved;
- loss of, or damage to, the motor vehicle caused by fire or theft,

but, "*in respect of no other matter*".

This regulation would exempt motor vehicle insurance providing cover for TPP or TPFT, however only if those products provide cover in respect of no other matter.

Most TPP and TPFT products provide some additional cover benefits, including:

- uninsured motorist cover, which covers the consumer's motor vehicle for loss or damage arising from an accident caused by the driver of an uninsured vehicle up to a specified limit; and/or
- cover for a hire car after a theft of the consumer's motor vehicle.

TPP and TPFT products with additional cover will not fall within the scope of regulation 12H, as they do not provide cover "*in respect of no other matter*". Those products would also not fall within the scope of regulation 12C, as they do not provide cover for all of the elements set out in that regulation.

In practice, this would lead to an illogical outcome, where a consumer could be sold a comprehensive motor vehicle insurance in connection with the purchase of a motor vehicle, without the DSM applying, but would be subject to the DSM with respect to a TPP or TPFT product.

It is submitted that this could be remedied by removing the limitation in regulation 12H relating to cover for other matters and replacing that with the words "*whether or not the product also provides insurance cover in respect of other matters*", as is used in regulation 12C.

Whether or not the cover is restricted

The definitions of add-on insurance products in regulations 12E, 12F, 12G, 12J, 12K and 12M each describe products that provide a specified scope of cover. While it would be open to conclude that add-on insurance products which have cover within that specified scope and also provide additional cover would come within the exemptions in these regulations, it is submitted that that would be made clearer by also including the words "*whether or not the product also provides insurance cover in respect of other matters*" in each regulation, as is used in regulation 12C.

Proposal

The Insurance Council proposes that:

- regulation 12H(c) be deleted and the opening words of regulation 12H(b) be amended as follows:

  (b) in respect of either or both of the following (<u>whether or not the product also provides insurance cover in respect of other matters</u>):

- the opening words of regulation 12E(1) be amended as follows:

  (1) Subject to subregulation (3), an add-on home and contents insurance product is an add-on insurance product that provides insurance cover (whether or not the cover is restricted <u>and/or whether or not the product also provides insurance cover in respect of other matters</u>) in respect of the destruction of, or damage to:

- the opening words of regulation 12F(1) be amended as follows:

  (1) Subject to subregulation (3), an add-on home building insurance product is an add-on insurance product that provides insurance cover (whether or not the cover is restricted <u>and/or whether or not the product also provides insurance cover in respect of other matters</u>) in respect of the destruction of, or damage to:

- the opening words of regulation 12G(a) be amended as follows:

  (a) provides insurance cover (<u>whether or not the product also provides insurance cover in respect of other matters)</u> to the insured person in respect of:

- the opening words of regulation 12J be amended as follows:

  An add-on transport and delivery insurance product is an add-on insurance product that provides insurance cover (whether or not the cover is restricted <u>and/or whether or not the product also provides insurance cover in respect of other matters</u>) in respect of…

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- the opening words of regulation 12K be amended as follows:

  An add-on travel insurance product is an add-on insurance product that provides insurance cover (whether or not the cover is restricted and/or whether or not the product also provides insurance cover in respect of other matters) in respect of any of the following:

- the opening words of regulation 12M(b) be amended as follows:

  (b) provides insurance cover (whether or not the cover is restricted *and/or whether or not the product also provides insurance cover in respect of other matters*) in respect of one or more of the following:

6. Additional exemption: Add-on livestock insurance

It is submitted that the Regulations should be amended to include "*add-on livestock insurance products*" as an additional class of exempt product.

In its submission of 1 March 2021, the Insurance Council referred to the challenges of implementing a DSM with respect to livestock insurance distributed at the point of sale of the animals. Reference was made, in particular, to the need for insurance to be obtained promptly to cover risks associated with transporting the animals from the point of sale. We appreciate that insurance for this transport risk has been addressed in regulation 12J, however we submit that will not be effective in exempting livestock insurance from the DSM given the breadth of cover provided by that product.

Livestock insurance normally provides cover for the injury, death and theft of sheep, cattle and bulls generally. While that includes cover for those events during transit, it is not limited to that. It is typically sold to the consumer by stock agents at auction not only because of the need to place cover promptly to address the risk of injury, death and theft during transit, but also to cover those risks generally. In that case, the insurance would likely be an add-on insurance product. The consumer can be an individual, such as a hobbyist, or a business.

Having regard to this, Add-on livestock insurance will not be exempt under the Regulations because:

- livestock insurance sold to a consumer in the course of their business is unlikely to have a premium in excess of $40,000, so will not fall within the add-on business insurance exemption set out in regulation 12L;
- livestock are not "*designated contents*" within the meaning of regulation 12A, so the exemption in regulation 12E will not apply; and
- although regulation 12J would exempt cover provided by the product with respect to loss in the course of transport or delivery, there could be uncertainty as to whether it exempts a product that provides cover for injury, death and theft of livestock more broadly.

The risks that livestock insurance is designed to protect arise immediately upon completion of the sale of the livestock (ie. the "*fall of the hammer*"). If a consumer is unable to obtain livestock insurance at that point, they will become exposed to an uninsured loss.

It is normally not practical for a consumer to obtain insurance cover before an auction because the necessary eligibility criteria for this insurance may not be known until the particular animal has been purchased. While a consumer could seek insurance cover in the stand-alone market immediately after the auction, they would be at risk until that cover has been placed.

This class of insurance is well established and its terms relatively standard. Members are of the view that it is well understood by most consumers likely to purchase it.

Proposal

The Insurance council proposes that:

- regulation 12A be amended to include:

  add-on livestock insurance product has the meaning given by regulation 12N.

- regulation 12B(1) be amended to include "*add-on livestock insurance products*"; and

- a new regulation 12N be included in the Regulations to the following effect:

  An add-on livestock insurance product is an add-on insurance product that provides insurance cover (whether or not the cover is restricted and/or whether or not the product also provides insurance cover in respect of other matters) in respect of loss, theft and loss of use of sheep, cattle, bulls or any other animal normally farmed in Australia, but not including domestic pets.

If you have any questions or comments in relation to our submission please contact Aparna Reddy, the Insurance Council's General Manager, Policy – Regulatory Affairs, on telephone: 02 9253 5176 or email: areddy@insurancecouncil.com.au.

Yours sincerely

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