Insurance Council of Australia

Quality of Advice Review Secretariat
Financial System Division
The Treasury Langton Crescent
PARKES ACT 260

By email: AdviceReview@treasury.gov.au

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Dear Ms Levy

Quality of Advice Review – Issues Paper

The Insurance Council of Australia (**ICA**) welcomes the opportunity to respond to the Treasury issues paper on the Quality of Advice Review (**the Issues Paper**).

The Insurance Council is the representative body of the general insurance (**GI**) in Australia and represents approximately 89% of private sector general insurers. As a foundational component of the Australian economy the GI industry employs approximately 60,000 people, generates gross written premium of $60.2 billion per annum and on average pays out $150.6 million in claims each working day ($38.8 billion per year).

Our submission primarily focuses on the exemption of GI products from the definition of conflicted remuneration for monetary and non-monetary benefits for general insurance. We also raise some further areas for exploration, namely the personal advice model. With respect to conflicted remuneration, this initial submission focuses on three key points:

- The exemption recognises the fundamental differences between GI products and other financial products subject to the conflicted remuneration regime. These fundamental differences should be considered in assessing any reform proposals.
- The GI market has undergone significant structural transformation in recent years, with a key driver being the introduction of various regulatory reforms following the Financial Services Royal Commission (**FSRC**). These reforms should be given time to consolidate, and the outcomes assessed prior to any further significant regulatory reforms.
- The structure of intermediated sales channels delivers benefits to consumers and facilitates competition and innovation. Any reforms should be considered in light of their potential impact to these channels and the broader competitive landscape and also recognise the distinct differences between such channels, including the diverse roles played by different intermediaries.

The ICA notes that the Issues Paper does not outline any potential reforms or outline any consumer harms, but instead seeks views on potential concerns. While there are distinct consumer advantages to the current model, insurers are open to considering reforms where consumer harm is identified and further strengthening of consumer protections is justified. Given the pace of regulatory reform within the insurance industry over the past few years (and considering upcoming reforms such as the consumer data right) any further changes should be justified by reference to clear evidence of consumer benefit.

We strongly suggest that any proposed reforms be tested with industry and other stakeholders prior to finalisation. Broader consideration should also be given to the effectiveness of recent reforms (discussed below) in addressing consumer detriment. The ICA understands the need to meet the timeframes outlined in the Financial Services Royal Commission to finalise this review and we are sympathetic to the compressed timeframes under which Treasury is operating. Thorough consideration of potential recommended reforms prior to finalisation will help minimise the risk that they require substantial regulatory modification in coming years.

Product Differences

The impetus for the future of financial advice (**FOFA**) reforms[1] was a series of financial product and services provider collapses, the most significant of which were Storm Financial and Opes Prime. The Parliamentary Joint Committee on Corporations and Financial Services (**PJC**) highlighted the significant harm that had impacted former investors, including meeting living expenses, repaying debts and keeping their homes.[2]

GI was exempted from this rule in recognition of the key differences between it and the financial products that had caused these significant hardships. These included:

- **Customer Understanding and Similarity of Products.** As the PJC recognised,[3] GI products are better understood by consumers when compared to other financial products. Consumers typically know whether they need GI, generally understand what GI policies do, how they are protected, and so on. Further, GI policies within the same category offer similar terms and coverage. By contrast, there can be significant variance within other categories of financial products. Different investment products, for example, can vary wildly in terms of risk, return, investment opportunity, and other matters.
- **Risk Profiles.** The risk profile of GI is different to most other financial products. A core concern of the FOFA reforms was the potential for consumers to unknowingly expose themselves to risk or take on greater levels of risk than intended. In contrast, insurance policies operate to protect policyholders from risk. GI policies do not have an investment component and policyholders are not exposed to additional financial risk merely by holding a GI policy.
- **Ease of Entry and Exit.** GI products are of fixed duration (usually twelve months) and can be cancelled without penalty.
- **Existing Statutory Duties.** The *Insurance Contracts Act 1984* imposes a statutory duty of "utmost good faith", and insurers are also liable for civil penalties for breach. There is an established body of industry practice and case law around this duty.
- **General Advice.** Distribution of retail GI products through intermediaries is typically conducted without the provision of personal advice. Where advice is provided, the intermediary would be operating under an Australian financial services licence and would therefore have a clear legal responsibility to act in their client's best interests.

GI can also be distinguished from other insurance products that have attracted regulatory attention. For example, broker commissions on life insurance products are capped.[4] This reflects historical concerns within that market regarding mis-selling of products. ASIC found that broker commissions could exceed

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[1] *Corporations Amendment (Future of Financial Advice) Bill 2011*; *Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011*
[2] Parliamentary Joint Committee on Corporations and Financial Services, *Final Report of the Inquiry into Financial Products and Services in Australia* (link) 19
[3] Parliamentary Joint Committee on Corporations and Financial Services, *Corporations Amendment (Future of Financial Advice) Bill 2011 and Corporations Amendment (Further Future of Financial Advice Measures) Bill 2011* (link)
[4] ASIC (June 2017), *17-168MR ASIC Releases Instrument Setting the Commission Caps and Clawback Amounts as Part of the Life Insurance Advice Reforms* (link)

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100% of the premium itself – in effect more than doubling the cost of the insurance.[5] Another concern was product "churn". As commissions trailed off post-sale (the annual commission paid to the broker would reduce steadily over time), this incentivised brokers and advisers to sell a customer a new product when their trailing commission hit zero. This would re-start the trail. As life insurance products were not necessarily "like-for-like", this added considerable expense and ended up with consumers shifting between quite different policies. These concerns are not present for GI products, which operate on quite different business models.

The ICA understands that questions around the conflicted remuneration exemption for GI products have been raised in previous inquiries. Given that these fundamental product features (outlined above) have not changed since the FOFA reforms, we would be keen to understand in more detail any specific consumer harms that have arisen because of conflicted sales. If there is evidence of consumer harms arising out of these arrangements, then the nature of the harms and the circumstances in which they occurred should be taken into account when developing policy solutions.

Further, as the Issues Paper notes, statutory consumer protections against the mis-selling of GI products have been significantly strengthened since the introduction of the FOFA reforms. New protections include design and distribution obligations, the prohibition on hawking, the deferred sales model for add-on insurance and the extension of the "unfair contract terms" regime to insurance contracts.

Any interventions would also need to consider broader impacts. For example, the Australian Securities and Investments Commission (**ASIC**) has stated that clear evidence of increased costs associated with competition or consumer access could warrant exceptions to the conflicted remuneration structures in certain cases[6] (in the case of GI products this would mean a continuation of exemptions). We note the ongoing policy interest in promoting insurance affordability and reducing under-insurance and suggest that these should also be key considerations.

The ICA looks forward to understanding the perspective of other stakeholders, identifying where consumer harm has arisen and appropriate remedies.

The Impact of Recent Reforms

As the Issues paper notes, statutory consumer protections against the mis-selling of GI products has been significantly strengthened since the introduction of the FOFA reforms. Issues that have previously been identified with products distributed through intermediated channels (such as high commission rates for some types of add-on insurance and some low-value insurance products) have been addressed.

- **Design and Distribution Obligations.** Described by ASIC Deputy Chair Karen Chester as a "game-changer" designed to "embed a consumer-centric approach",[7] these obligations require firms to design financial products that are likely to be consistent with the likely objectives, financial situation, and needs of the consumers for whom they are intended.

- **Deferred Sales-Model for Add-on Insurance.** The deferred sales model for add-on insurance introduces a four-day pause between the sale of a primary product and the sale of an add-on insurance product, to help individual customers make informed decisions when purchasing insurance.

[5] ASIC (October 2014) *Report 413: Review of Retail Life Insurance* (link)
[6] ASIC, *Response to the Interim Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry* (link) 27
[7] ASIC, *20-320MR ASIC Releases Regulatory Guide on Product Design and Distribution Obligations* (link)

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- **Strengthening of Hawking Prohibition.** Working in conjunction with the deferred sales model, the anti-hawking restrictions put certain prohibitions on insurers offering products to consumers while selling other products. The ICA supports monitoring the reforms.
- **Unfair Contract Terms Regime.** These protections have applied to insurance contracts since April 2021 and mean contracts with consumers or small business may be void if the term is unfair, the term is a standard contract, or the contract is a financial product.
- **Duty Not to Make a Misrepresentation.** A duty to take reasonable care not to make a misrepresentation to an insurer places the burden on an insurer to elicit the information that it needs in order to assess whether it will insure a risk and at what price.
- **Breach Reporting Obligations.** Financial services firms including insurers are required to report to ASIC any significant breaches of their obligations as Australian Financial Services Licensees. The new regime aims to address concerns of uncertainty about when breaches are significant enough to report, and to improve the consistency of information provided by licensees in their breach reports.
- **Claims Handling as a Financial Service.** A claims handling and settling service includes assisting someone make a claim and range of other prescribed engagements between insurers and the insured or their representative.
- **Enforceable Industry Codes of Conduct.** The 2020 General Insurance Code of Practice came into effect on 1 July 2021 and sets out the standards that general insurers must meet when providing services to their customers.

Each of these introduced significant structural change with respect to insurer-customer interactions. Variously, the prohibited certain forms of interaction, imposed new duties on insurers, granted new rights to consumers and provided new powers for regulators.

Moreover, there is an expectation of further regulatory reform in the immediate future. Legislation enabling the compensation scheme of last resort, financial accountability regime and enhancements to the unfair contract terms regime lapsed prior to the May 2022 election and will likely be revisited. The Government has also announced that GI will form part of a forthcoming “open finance” consumer data right designation.

These reforms (recently implemented and planned) need time to consolidate before we can accurately understand their impact and assess the need for further regulatory intervention. The ICA again notes that it is keen to understand the perspective of other stakeholders to help identify where any consumer harm has arisen. If there are specific areas of consumer detriment, the industry would be keen to work with stakeholders to identify potential solutions.

Intermediated Insurance Sales

Drawing on the industry’s experience in working with ASIC to implement the deferred sales model (**DSM**) for add-on insurance, this section outlines some of the features and customer benefits of sales through intermediated channels. This section makes the following points, each of which is elaborated below:

- Intermediated channels deliver customer benefits that may be hard to replicate through other channels, including adding significant ***reach***.
- GI products delivered through intermediated channels have historically represented good value for customers.
- There are broader public interest benefits associated with the types of insurance provided through intermediated channels.

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- The potential impacts on market structure and competition between insurers of any reform proposals will need to be considered, including the impact on the distribution channels themselves (many of which are small businesses).

While these points address questions around intermediated channels, the Issues Paper is specifically addressed to the question of the compensation structures within those channels. Nonetheless, this discussion should provide a starting point for considerations. Treasury will need to weigh these benefits against any detriment that is identified through this consultation process. Should any consumer detriment be identified, the ICA is happy to work with Treasury and other stakeholders to develop policy outcomes that appropriately balance these interests.

Market Structure: Intermediaries

GI products are delivered across a range of channels. In addition to direct provision of insurance (general insurers who market products directly to consumers), there are various intermediated models. Intermediated channels represent a significant overall percentage of all premiums written in Australia, being estimated at 47% in March 2020. These include insurance brokers, online aggregators, intermediaries acting on behalf of insurers (such as financial institutions and motor dealers), and underwriting agencies (who manage the product value chain on behalf of an insurer). These models represent different distribution channels.

In general, intermediaries are either acting on behalf of the customer or acting on behalf of an insurer. Insurance brokers are most likely to be acting on behalf of the customer, where they play an important role on advising consumers on risks, identifying appropriate products from a range of product issuers, facilitating the purchase of insurance and assisting consumers to lodge claims.

Other intermediaries acting on behalf of an insurer (under their own Australian financial services licence or as the insurer's Authorised Representative) generally do not play such role in advising consumers about a range of products and may have arrangements in place with one insurer for distributing a specific product. Examples include a bank that offers home insurance or an underwriting agency providing coverage for a specialist product such as farm or strata. The bank, in that example, might distribute a white-label product – on their own branding but underwritten by an insurer. These intermediaries do not play an advisory role like brokers do, and so the risk of any remuneration creating conflicts of interest incentivising the recommendation of one product over another is more limited.

This brief discussion begins to highlight some of the benefits of the variety of distribution channels, which will be expanded below.

Customer Benefits

With appropriate consumer protections in place, intermediated sales channels can provide unique value to consumers by providing a timely and convenient path for retail customers to obtain insurance coverage. Identified benefits of intermediated channels at point of sale include:

- The customer can obtain immediate cover for their asset, protecting not only their own financial liabilities, but also those of third parties – for example with boat insurance.

- Insurance may be forgotten – in the excitement of purchasing a new asset (such as a home or car) or a holiday package, a person may not think to pre-arrange insurance or may not have the information necessary to do so. A person may also forget to arrange insurance at a later time. In other scenarios a purchaser may not be aware that other insurance products don't cover their purchase, such as a caravan purchaser who (incorrectly) assumes that their car insurance product coverage would extend to their caravan.

- Alternative methods of procuring insurance may be challenging or impossible for some consumers to navigate – for example, some customers, may not have access to, nor the capacity to purchase insurance online.
- Insurance may be legally required, such as compulsory third party, or contractually required, such as home insurance in the event of a entering a home loan.
- Introducing more competition into the system which facilitates better outcomes for customers and more investment in innovative approaches.

These examples illustrate the important role that intermediaries play in ensuring consumer understanding of the need for insurance and any risks of underinsurance. Such benefits could be difficult to replicate outside of intermediated channels, and any reforms would need to consider how these benefits could continue to be captured.

Historical Customer Value

Many of the products distributed via intermediated channels have historically represented good value for customers. Overall, “value” from the consumer perspective can be defined broadly as a “tangible benefit for a reasonable cost”. When measuring customer value, several factors are relevant. One instructive metric is industry loss ratio, which represent the amount insurers pay out in claims as a portion of premiums.

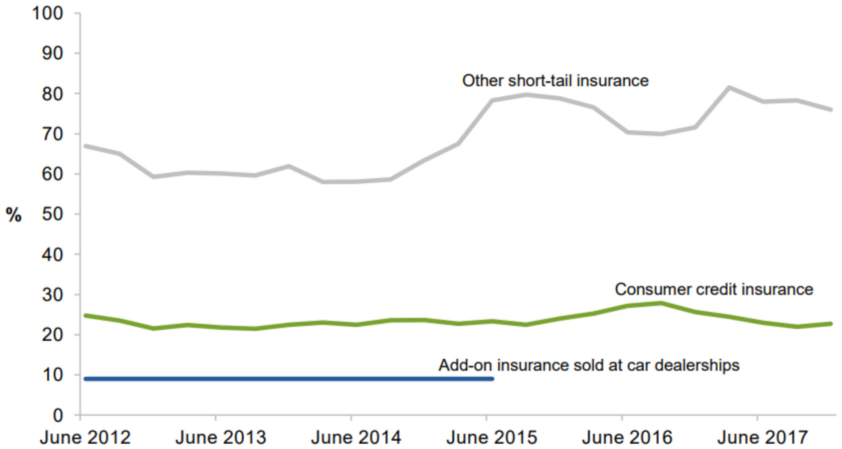
While the ICA notes several strong caveats with evaluating customer value based on gross loss ratio alone, it nonetheless represents a useful metric.[8] The following table provides an overview of gross loss ratio by class of business, illustrating a good level of overall consumer benefit across different classes of business. While the below table does not differentiate between direct and intermediated insurance, the ICA notes that we have provided Treasury with non-public data that does offer this comparison.

Class of business	**Gross loss ratio for risks located in Australia**						
	Year-end Sept 2015	Year-end Sept 2016	Year-end Sept 2017	Year-end Sept 2018	Year-end Sept 2019	Year-end Sept 2020	***6-year average***
Households	70%	55%	63%	52%	71%	90%	***67%***
Commercial motor	89%	85%	92%	86%	84%	75%	***85%***
Domestic motor	91%	90%	93%	88%	91%	78%	***89%***
CTP	89%	83%	59%	60%	63%	80%	***72%***

[8] In summary: An approach of judging customer value on gross loss ratio alone (and in setting the ratio at an unreasonably high level) would in effect be setting a requirement for insurers to have reduced profitability and prudential stability, with flow-on implications for customers, shareholders and the economy. Nor does it take into account the need for premiums to fund insurers other expenses (such as employee costs, premises, utilities, reinsurance costs, regulatory and compliance costs, and other overheads). Additionally, it does not take into account differences in loss ratio volatility – some products (such as motor) will have relatively steady loss events, while others will exhibit more volatility. For example, home insurance will vary due to seasonal natural disaster events and consumer credit insurance will peak during economic downturns. Finally, more qualitative elements of customer value may not be captured.

This metric was used by the Productivity Commission in its 2018 inquiry *Competition in the Australian Financial System* to compare "add-on" products with which it held customer value concerns (consumer credit insurance and add-on insurance sold at car dealerships) with other classes of short-tail insurance (such as home, motor and marine).[9] The resulting analysis demonstrates the significant difference between the limited products previously identified as of concern and other insurance products available on the market and reinforces the ICA's earlier point that any policy interventions should be tailored to areas of concern rather than imposing a blanket rule across the market:

Figure 15.3 **Add-on insurance products are relatively poor value for money**
Annual share of premiums returned in claims by class of insurance[a]



[a] Calculated as annual gross earned premiums divided by annual gross incurred claims (also known as the gross loss ratio). Long-tail insurance policies are excluded because of the potential for inconsistency between the periods in which premiums are registered and claims are made.

Source: ASIC (2016a); Productivity Commission estimates based on APRA (2018q)

Public Interest

There are public benefits alongside the broad consumer benefits associated with the provision of insurance through intermediary channels. Broadly, where products offer good consumer value, there is significant benefit in being able to obtain financial protection alongside the purchase of a good or service.

Home insurance protects the homeowner from financial risk associated with what – for many Australians – is their most valuable asset. This includes protection from the financial risk associated with natural disasters – the cost of insurance claims from natural disaster catastrophes declared over the 2019-20 summer was nearly $6 billion. Without insurance, these costs would have been borne by individuals, with governments contributing through national disaster recovery funding arrangements. Other classes of insurance have similar benefits, including motor vehicle and boat insurance (boat insurance also provides cover for personal injury to third parties in the absence of a national statutory scheme).

Travel insurance, which is often sold through travel agents or websites, is another example where intermediated sales channels support public policy goals. The Australian Government recognises the advantages of travel insurance,[10] and has stated that, during the COVID pandemic, "it has never been more important to secure travel insurance".[11] Any future reform proposals would need to consider the

[9] Productivity Commission (2018) *Competition in the Australian Financial System* (link) 420
[10] Department of Foreign Affairs and Trade (accessed May 2022) *Smart Traveller – Travel Insurance* (link)
[11] Department of Foreign Affairs and Trade (accessed May 2022) *CHOICE Travel Insurance Buying Guide: COVID-19 Edition* (link)

impact on these broader objectives. Failure to purchase travel insurance can have a significant impact if, for example, an individual requires hospitalisation.

There are other intangible benefits to intermediated structures. Insurance brokers are playing an important interface role following the recent catastrophic flooding in NSW and Qld. They have strong local knowledge and are able to effectively offer customer support and advice.

The ICA again notes that these considerations do not necessarily rule out reform proposals in and of themselves. However, they should be taken into account in future considerations.

Impacts on Market Structure and Competition

Distribution models differ between general insurers. Indeed, this is a point of competition amongst our members. Some general insurers operate principally through direct sales, others through intermediated models and others have a mixture. The Australian Competition and Consumer Commission estimates that approximately 35% of consumers buy home and/or contents insurance purchase via an insurance intermediary,[12] which points to significant competition within the market for home and contents insurance. Reform proposals that would significantly impact one channel should be considered in light of the potential effect on market competition and flow-on impacts for consumer choice and accessibility.

Insurers incur acquisition costs with all forms of distribution, whether direct or intermediated. It is not the case that intermediated channels automatically translate to inflated costs. Direct insurers may incur these costs in the form of staff training, marketing and advertising and IT systems (for example), while intermediated insurers incur costs in the form of commissions. A range of factors in recent years, such as a growing direct market and the shift towards digital insurance purchases have acted to put downward pressure on commissions. It may therefore be useful to compare different categories of acquisition costs when considering potential competition impacts. For example, some state-based statutory schemes require the reporting of these different types of insurer expenses separately, which would facilitate such a comparison.[13]

Indeed, for many intermediated channels, remuneration can be limited. For some, such as mortgage broking, real estate agents or motor vehicle dealerships, the insurer will often only remunerate a token amount, principally to cover administrative costs. While such payments may be nominally described as "conflicted remuneration", it is unclear that the small amounts of remuneration involved would be the cause of any consumer detriment.

Conversely, should these remuneration arrangements be removed or significantly altered, the seller may simply cease to offer insurance and that channel would vanish. This would increase under-insurance and limit many of the consumer and public interest benefits outlined above. This has been the experience in the financial advice industry, which has seen a significant reduction in the number of financial advisers alongside an increase in advice cost.[14]

Other Areas for Consideration

Financial Product Advice Regime for General Insurance

As previously noted by the ICA, the current advice regime hinders insurers from engaging and assisting consumers with choosing policies best suited to their needs.[15] Under the current regime, the delineation between general advice, personal advice and factual information can be fine. As a result, insurers are

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[12] ACCC Northern Australia Insurance Inquiry, Final Report, p.17
[13] For instance, State Insurance Regulatory Authority (NSW), *Motor Accident Guidelines* (Version 8.2)
[14] Independent Financial Adviser (April 2022) *Over 2,000 more advisers predicted to exit industry in 2022* (link)
[15] ICA (March 2018), *Submission to the Productivity Commission, Competition in the Australian Financial System* (link) 3

disincentivised from freely offering advice to consumers in relation to their products, out of fear of it becoming personal advice which attracts a wide array of obligations. In our view, there is no need to treat general insurance advice in the same way as investment advice – general insurance products are inherently different from investment products, as they meet a simpler need and are less risky.

In ASIC Report 415 Review of the sale of home insurance, consumers who called their insurer frequently sought assistance about how to best decide on a sum insured amount. In many instances, sales staff advised they were not able to provide any assistance and most consumers went on to make uniformed and therefore poor decisions in relation to the sum insured amount. This is exacerbated by the fact that many consumers do not read and/or understand the factual information that is provided to them in disclosure documents when making their decision. On the whole, consumers want and need advice – they pay more attention to what they are told by sales staff rather than disclosure documents.

For this reason, we support a review of the advice definitions. One option is to consider whether a new level between "general" and "personal" advice is needed and make clear that insurers can discuss key questions with customers such as choosing policies with appropriate cover, the most appropriate level of sum insured and levels of excess (among other matters). This could help to improve the targeting of insurance and reduce incidences of inappropriate insurance or under-insurance.

The ICA's submission to the Australian Law Reform Commission (**ALRC**) *Financial Services Legislation "Interim Report A"* provides more detail on our views.[16] As discussed above, the distinction between general advice and personal advice can be fine. Recent judicial interpretation of the terms illustrates a significant level of uncertainty regarding their application in practice. Given the quite different regulatory requirements that apple to personal advice, it is essential that these distinctions remain clear.

Finally, the ICA notes the ALRC's proposal to amend 961B(2) of the *Corporations Act* and repeal sections 961C and 961D. As discussed in our submission to the ALRC, the ICA views that this would introduce considerable uncertainty as to whether a person providing personal advice has met their best interests duty. This change would particularly impact persons advising on GI products. Given the consequences of a breach of the best interests duty, these proposed changes would likely discourage some providers from continuing to give personal advice to their customers.

Next Steps

We trust that our initial observations are of assistance. If you have any questions or comments in relation to our submission please contact Aparna Reddy, General Manager, Policy – Regulatory Affairs, on 0427 902 960 or areddy@insurancecouncil.com.au.

Yours sincerely

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[16] ICA (March 2022) *Submission to the Australian Law Reform Commission, Financial Services Legislation "Interim Report A"* (link) 16-17