

Regulatory Burdens Review
Productivity Commission
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Email: fnugent@pc.gov.au

Attention: Mr Frank Nugent
Research Manager

26 February 2010

Dear Mr Nugent

**ANNUAL REVIEW OF REGULATORY BURDENS ON BUSINESS: BUSINESS AND
CONSUMER SERVICES – GENERAL INSURANCE**

The Insurance Council of Australia Limited (Insurance Council) appreciates the opportunity to provide input to the review by the Productivity Commission (PC) into the regulatory impediments in the general insurance sector. This submission builds on the discussion that we had on 9 December 2009 with you and your colleagues conducting the review.

The Insurance Council is the representative body of the general insurance industry in Australia.¹ 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 Australian financial services system. Australian Prudential Regulation Authority (APRA) statistics (for the period to September 2009) show that the private sector insurance industry generates gross premium revenue of \$32.2 billion per annum and has assets of \$94.7 billion. The industry on average pays out about \$96.4 million in claims each working day.

The general insurance industry plays an important role in ensuring the smooth operation of the national economy with insurers pricing risk and absorbing losses against the pool of insurance premiums. This effective management of risk allows individuals to engage in day-to-day and riskier activities such as starting a business or purchasing a large item, fostering higher levels of economic activity.

It is generally recognised that the rigour of the Australian regulatory regime enabled the economy to cope better than those of most other economies with the challenges of the global financial crisis and ensuing economic difficulties.² This is particularly the case with the general insurance sector where companies remain sound.³ The following comments should be seen against the Insurance Council's general recognition of the value of a sound and effective regulatory regime for financial services.

¹ 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 Laker J F, Chairman APRA, "The Regulatory Landscape 2009-2010", paper presented to the Finsia Financial Services Conference 2009, Sydney, 28 October 2009, pp1-2.,

³ See: APRA, *Annual Report 2009*, p 17; KPMG, *General Insurance Industry Survey 2009*, September 2009, pp 2-3.

The personal advice requirements of the Corporations Act are too cumbersome for general insurance products

The financial services regime (FSR) that commenced in 2004 was predicated on the benefits of having uniform regulatory requirements across financial services. This had undoubted advantages in improving consumer certainty and regulating products in line with what they are rather than according to the type of institution that offers them. However, FSR has contributed to some poor outcomes in the general insurance sector.

Fulfilling the personal advice requirements of the Corporations Act, which may make sense for investment products, is overly cumbersome for general insurance products that are typically simple in nature, run for a set period of time, can generally be cancelled at any time with a refund of the balance of premium and changed at renewal, have a cooling off period and do not involve any risk in terms of lost income or investments.

A general insurer may be selling its products through agents who sell only general insurance products, or only sell general insurance as a secondary service to their customers (motor dealers, travel agents, real estate agents). Under the current regime, these agents are deemed to be financial advisers and what should be a 'simple' sales discussion with the consumer becomes a protracted compliance process concerning the policy document.

Consumers have also raised concerns around what has been perceived as an unnecessary process of consultation and documentation. Feedback from insurance agents is that they spend a significant amount of time explaining to a customer why they need to go through such a complex process when all the customer is interested in knowing is whether the cover meets their needs and the level of premium payable.

While many consumers require factual information and would prefer that only general advice be provided, the operation of the general and personal advice definitions has driven many insurers and insurance agents to operate a 'no advice' business model. This is clearly not a good outcome for those clients who would like more information before making a decision. Resolving this problem will not be easy. Please see the Insurance Council's submission of 18 September 2007 (attached) on a possible solution.

Government action has helped reduce the regulatory burden for general insurers

The Insurance Council acknowledges that refinements to FSR have removed some of the unwarranted regulation flowing from applying a common regulatory model across financial services sectors. Credit should also be given to the work of the Financial Services Working Group in simplifying and improving the effectiveness of financial services disclosure documents.

Furthermore, successive Government's have made significant efforts to reduce the regulatory burden on financial services providers. For example, the implementation of recommendations from the Banks Report through the Simpler Regulatory System Act 2007 addressed the problem of duplicated and inconsistent regulation by the Australian Securities and Investments Commission (ASIC) and APRA.

The Insurance Council also acknowledges the work done at the Commonwealth and State level to improve the general standard of regulation. Initiatives such as the Australian Government's Best Practice Regulation Handbook have provided both guidance to regulators and benchmarks against which they could be judged.

The need for a strong, efficient, and well managed Australian economy

In terms of policy settings that would enable general insurers to develop their businesses within Australia and offshore, Insurance Council members have consistently identified that their first priority is a strong, efficient, and well managed Australian economy. If our members can operate their businesses profitably, this puts them in a strong position to compete strongly and grow both domestically and in international markets.

Consequently, the Insurance Council is a strong advocate of:

1. the elimination of inefficient State taxes on insurance i.e. stamp duty on insurance contracts and the current fire service levy;
2. a regulatory environment which, while providing a safe financial environment for Australians, also facilitates a globally competitive financial services sector;
3. a uniform national financial services regulatory regime, with residual State responsibilities being handed to the Commonwealth; and
4. appropriate prudential regulation of insurance groups, recognising the regulation already imposed on subsidiaries in foreign jurisdictions.

The Insurance Council would like to take the opportunity of expanding upon the first and third of these objectives.

Reform of State taxes

The Insurance Council has made a number of submissions to government reviews wherein the Insurance Council firmly outlines the case of reform of insurance taxation. Most notably, in its submissions to the Review of Australia's Future Tax System (AFTS) the Insurance Council strongly urges reform of insurance taxation (and transaction tax reform more generally) through a process of Commonwealth/State financial sector reform and importantly, by encouraging a State tax mix switch away from inefficient State taxes (such as stamp duties) towards more efficient State taxes (for example, payroll taxes).

As the Insurance Council concludes in its supplementary submission to the AFTS Review: ⁴

"... in this supplementary submission, the Insurance Council has gone further in providing advice to the AFTS as to an appropriate tax mix package that would allow the goal of removing inefficient transaction taxes. The tax mix package would see a switch away from inefficient State based transaction taxes to be replaced by a considerably more efficient and harmonised and centralised payroll tax regime. This tax package accrues significant economic welfare gains adding some 1% to real household consumption. A package of this type is best delivered in a new round of Commonwealth/State Financial reform".

The reform gains achievable from improved State taxation mixes is also evident from the work of the Insurance Council for the Victorian Parliament. In the Insurance Council submission to the Victorian Parliamentary Committee Inquiry into State Taxation & Debt (copy included) the Insurance Council draws attention to the gains that accrue to the State of Victoria if State transaction taxes were replaced by more broadly based State taxes. ⁵

⁴ Insurance Council of Australia (April, 2009) "Supplementary Submission to the Review of Australia's Future Tax System" available at [http://www.insurancecouncil.com.au/Portals/24/Submissions/043009%20-%20SUB%20-%20AFTS%20Supplementary%20Submission%20\(April%202009\).pdf](http://www.insurancecouncil.com.au/Portals/24/Submissions/043009%20-%20SUB%20-%20AFTS%20Supplementary%20Submission%20(April%202009).pdf)

⁵ Insurance Council of Australia (October, 2009) "Submission to the Victorian Parliamentary Economic Development & Infrastructure Committee Inquiry into State Government Taxation & Debt" available at

The Insurance Council looks forward to the release of the AFTS Review. In this regard, the Insurance Council welcomes the publication of the report of the Australian Financial Centre Forum (the Johnson Report) which has also recommended the abolition of state taxes and levies on insurance. Of particular note is the remark of the AFCF that it has had discussions with the Review of Australia's Future Tax System on the issues associated with taxation on insurance and the observation by the AFCF that the impact of State taxes on insurance is "on the agenda" of the AFTS review.⁶

Harmonisation of the regulation of State-based insurance

In relation to the third policy objective set out above, it is of concern to our industry that the regulation of State-mandated lines of insurance such as Compulsory Third Party (CTP) and Workers' Compensation varies widely from State to State.

The need to comply with different regulations in each jurisdiction and also the requirement in practical terms often to have individual State/Territory operations (for example separate personnel and IT systems) makes it difficult for insurers to achieve economies of scale and manage risks efficiently. In addition, workers' compensation generally remains a very complex area for businesses, especially for employers with employees in multiple jurisdictions who deal with the cost and complexity of up to eight different workers' compensation regimes.⁷

The Insurance Council recognises that there are significant issues involved in determining an appropriate basis for the harmonisation of these State-based schemes. Such issues go to the heart of the policy reasons why a government mandates a particular insurance requirement, such as CTP. We recognise that it may take some time to address these policy questions satisfactorily for all stakeholders across all Australian jurisdictions.

The Insurance Council is a keen supporter of the Council of Australian Government's goal of achieving a seamless Australian economy and endorses the work it is doing in the first instance to harmonise Occupational Health and Safety requirements.

The Insurance Council notes that the Johnson Report also demonstrated the benefits of a single national regulatory system for general insurance.

The threat of regulatory overload

From our opening remarks in this submission, we hope you appreciate that the Insurance Council understands the importance of effective regulation of financial services and the need to ensure that the global financial crisis has not revealed weaknesses in the regulatory regime that need to be addressed. However, the Insurance Council would like to draw attention to the fact that the financial services industry has faced major regulatory change for more than a decade. This has been from the 1996 with the Wallis Inquiry, the lead up to and development of the FSR reforms, implementation of a new regulatory regime, continual refinements to eliminate problems with the new regime, and major extensions of regulation through for example the National Credit Code and the Australian Consumer Law.

[http://www.insurancecouncil.com.au/Portals/24/Issues/Vic%20Parliamentary%20Committee%20Tax%20Inquiry%20October%2009%20\(Final\).pdf](http://www.insurancecouncil.com.au/Portals/24/Issues/Vic%20Parliamentary%20Committee%20Tax%20Inquiry%20October%2009%20(Final).pdf)

⁶ Report by the Australian Financial Centre Forum (November, 2009) "*Australia as a Financial Centre: Building on Our Strengths*" at page 73

⁷ We note the Productivity Commission's 2004 report on *National Workers' Compensation and Occupational Health and Safety Frameworks* in which the compliance burden and cost of multiple arrangements (particularly for multi-state employers) is discussed (see p XXVI and XXXII, and pp17-21).

This is not to say that the Insurance Council disagrees with the policy intent of these regulatory initiatives. Constant regulatory change and adjustments does come at a cost, both in terms of the staff of financial services providers that need to implement the change and especially in terms of the management attention that is diverted from the actual business of financial services to ensuring that an organisation's regulatory compliance is satisfactory.

As discussed with you on 9 December 2009, the problem is a difficult one and serious consumer detriment should not go unaddressed. However, the Insurance Council suggests that in relation to some measures the consumer benefit may be so relatively minor, there would be advantage to leaving such changes to a later time, leaving industry to focus on meeting the financial services needs of their customers.

Yours sincerely

Karl Sullivan
Acting Chief Executive Officer

Mr Jim Murphy
Executive Director Markets Group
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18 September 2007

Dear Mr Murphy

GENERAL INSURANCE AND ADVICE UNDER THE CORPORATIONS ACT

The Insurance Council of Australia Limited¹ (Insurance Council) appreciates the open dialogue being conducted by Treasury with industry on how to deal with the issues which the sales recommendation proposal² sought to address. While Insurance Council submissions supported the proposal³, we acknowledge that there were significant concerns about its impact on other sectors of the financial services industry.

The Insurance Council therefore understands, and indeed endorses, the Government's decision to establish a separate process outside of the Simpler Regulatory System Bill to address problems caused by the definitions of financial product advice in the Corporations Act (the Act). The purpose of this submission is to set out clearly the issues and a possible way forward for general insurance as seen by the Insurance Council's members.

Altering the line between general and personal advice will not address the issue

In seeking to better balance consumer benefit through information disclosure with the resulting compliance burden on business, suggestions have been made to adjust the definitions of general and personal financial product advice. The Insurance Council is aware of proposals in other industry submissions to adjust the definitions so that advice is general rather than personal if it is given in relation to a class of product and not a particular product. Also, it has been suggested that personal advice should not cover situations where it was clear that neither party intended the advice to be relied upon in taking a decision in relation to a financial product.

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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 Proposal 1.1 of the November 2006 proposals paper, *Corporate and Financial Services Regulation Review*.

³ Insurance Council submissions to Mr Jim Murphy, Treasury, of 22 December 2006 and 9 February 2007.

The Insurance Council acknowledges the sense of these proposals and in general supports their serious consideration as a means of improving the effectiveness of parts of the financial services regulatory regime. However, their impact would be negligible in addressing the problems experienced with general insurance as general insurers when selling their products want to be able to talk about particular products and intend their advice to be acted upon by consumers purchasing general insurance policies.

Personal Advice Obligations Too Onerous for General Insurance in Most Cases

Apart from situations where only product information is provided, in discussing general insurance with a client it is clear that a general insurer or their representative will often meet the fundamental test of personal advice – the consideration of one or more of a client's objectives, financial situation or needs. This triggers a number of obligations under the Corporations Act.

The Insurance Council acknowledges that the Government has provided exemptions from the need to provide a Statement of Advice (SoA) in relation to most classes of general insurance⁴. This relief is greatly appreciated and makes a real difference to the compliance burden. In addition, certain types of general advice do not constitute providing a financial service, including general advice that is not about a particular product and does not attract remuneration⁵ and general advice given by an issuer about its own product⁶.

The personal advice obligations which remain are:

- To have a reasonable basis for the advice (s945A);
- To warn the client if the advice is based on incomplete or inaccurate information (s945B);
- To provide a Product Disclosure Statement (PDS) (s1012A)

Of these, the most onerous is the requirement to have a reasonable basis for personal financial product advice set out in s945A:

- (1) The providing entity must only provide the advice to the client if:
 - (a) the providing entity:
 - (i) determines the relevant personal circumstances in relation to giving the advice; and
 - (ii) makes reasonable inquiries in relation to those personal circumstances; and
 - (b) having regard to information obtained from the client in relation to those personal circumstances, the providing entity has given such consideration to, and conducted such investigation of, the subject matter of the advice as is reasonable in all of the circumstances; and
 - (c) the advice is appropriate to the client, having regard to that consideration and investigation.

Fulfilling the personal advice requirements of the Corporations Act, which makes sense for investment products, is overly cumbersome for general insurance products that are typically simple in nature, run for a set period of time, can generally be cancelled at any time and changed at renewal, have a cooling off period and do not involve any risk in terms of lost income or investments.

⁴ See s946B(5)(c) of the Act and reg. 7.7.10 (d)-(i).

⁵ See reg 7.1.33G.

⁶ See reg 7.1.33H.

A general insurer may be selling its products through agents who sell only general insurance products, or only sell general insurance as a secondary service to their customers (motor dealers, travel agents, real estate agents). Under the current regime, these agents are deemed to be financial advisers and what should be a 'simple' sales discussion with the consumer becomes a protracted compliance process concerning the policy document.

Consumers have also raised concerns around what has been perceived as an unnecessary process of consultation and documentation. Feedback from insurance agents is that they spend a significant amount of time explaining to a customer why they need to go through such a complex process when all the customer is interested in knowing is whether the cover meets their needs and the level of premium payable.

While many consumers require factual information and would prefer that only general advice be provided, the operation of the general and personal advice definitions has driven many insurers and insurance agents to operate a 'no advice' business model. This is clearly not a good outcome for those clients who would like more information before making a decision.

Application of Sales Recommendation Proposal to General Insurance

The sales recommendation proposal made by the Parliamentary Secretary to the Treasurer was that in certain situations, financial product advisers and their representatives would be able to recommend financial products based on their client's objectives, financial situation and needs without that recommendation constituting either general or personal advice.

Although a sales recommendation may contain elements of personal and/or general advice and would still be a form of financial service, it would not be captured by the personal and general advice definitions.

The sales recommendation framework involves the following elements:

- A person is a representative of:
 - a licensed product issuer and the representative only deals in and makes sales recommendations on financial products on behalf of that issuer (or another issuer if they represent more than one issuer, whether or not it is a related body); or
 - a licensee and the representative only deals in and makes sales recommendations on financial products on behalf of a product issuer related to the licensee (or any other issuer if they represent more than one issuer, whether or not it is a related body).
- Representatives who are licensed to provide sales recommendations would be prohibited from holding themselves out as providers of financial advice.
- A financial product is recommended and the appropriate product-related disclosure is provided i.e. a PDS or other disclosure.
- The person recommending the product specifies all of the following up front and in writing (except where oral disclosure is permitted) in a Sales Recommendation Warning.

The Insurance Council supported the sales recommendation proposal in its submissions on the Corporate and Financial Services Regulation Review and still believes that its application to general insurance would be generally beneficial. It would enable and encourage general insurers to provide their customers with information after considering their needs. The consequences of this would be more informed decisions on general insurance purchases which could only go to improve Australia's high rates of non and under insurance. The precautions outlined above would make it highly unlikely that a customer who received a sales recommendation would mistakenly believe that they had received a personal advice recommendation.

Consumer Protection

In considering the sales recommendation proposal, we believe it is important to remember that the ASIC Act 2001 imposes a number of requirements that would apply to sales recommendations: the unconscionable conduct prohibition; the misleading or deceptive conduct prohibition; the false or misleading representation prohibition; and the misleading conduct prohibition. Being a licensed activity, the general licensing regime in Chapter 7 of the Corporations Act would also apply. Furthermore, the comprehensive provisions of the Insurance Contracts Act would continue to protect those taking out general insurance, in particular insurers are responsible for the actions of their representatives including where a policy is purchased based on incorrect or incomplete information.

Importantly, Insurance Council members (responsible for 90% of the Australian general insurance market) are also bound to uphold the comprehensive provisions of the General Insurance Code of Practice (the Code). The Code has been designed to raise the customer service standards in the Australian general insurance industry and protect the rights of policyholders. General principles covered by the Code of Practice include:

- All customer services (including product information, sales procedures, claims handling and the management of complaints or disputes) will be conducted in a fair, transparent and timely manner.
- If an error is made in assessing applications, deciding on claims or investigating complaints, the insurer will take immediate action to correct it.
- Customers will have access to any information that has been used to assess applications, claims or complaints and will have the opportunity to correct any mistakes or inaccuracies within this information.
- Insurers will make sure that not only its employees, but also its Authorised Representatives and Service Providers meet the standards in the Code.

Members' compliance with the Code is monitored by the Insurance Ombudsman Service.

Competitive Neutrality

The Insurance Council wishes to make it clear that it is submitting that the ability to make sales recommendations in relation to general insurance would be an additional, separate category of regulation and would not replace the operation of the general and personal provisions for general insurance. Consequently, in situations where consumers want a recommendation of general insurance appropriate to their circumstances, the personal advice obligations would still apply.

Insurance Council members are not seeking a competitive advantage over other licensees who may sell general insurance. Consistent with this, the Insurance Council endorses representatives of an insurance broker being able to make sales recommendations if that is all the individual representative does. It would be confusing for consumers if any representative, not only for broker licensees could alternate between being giving general or personal advice and making sales recommendations. The licensee may however have representatives in both capacities.

Training Standards

The Insurance Council notes that introduction of a sales recommendation category would only be partially effective to facilitate the provision of basic product information to consumers. The question of training standards must also be addressed. The current level of required training

exceeds that required to enable product advisers to sell general insurance products effectively. It therefore poses a considerable cost burden.

Consequently, in responding to ASIC's consultation paper on the review of RG 146, the Insurance Council will be supporting the removal of the generic knowledge requirement for all courses covering Tier 2 products and licensees being able to self-assess courses for advisers on Tier 2 products. The training for general insurance product advisers should focus on specialist knowledge training and skills training if providing a sales service or a financial advice service. The selling of simple products such as general insurance does not require familiarity with generic knowledge.

The Insurance Council is heartened by the positive signs from ASIC that it will move to facilitate the appropriate training for advisers dealing in general insurance products. We would appreciate Treasury being mindful that action is necessary on both regulation of financial product advice on general insurance and training standards if general insurers are to more readily provide general advice to their clients which will promote informed decision making. The result is likely to be an improvement to Australia's high rates of non and under-insurance.

The Insurance Council would be pleased to meet with Treasury representatives at the earliest convenient time to discuss the feasibility of the introduction of the sales recommendation category for general insurance.

Yours sincerely

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