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Submission to the Parliamentary Joint Commission on Corporations and Financial Services- the Life Insurance Industry

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1.The need for further reform and improved oversight of the life insurance industry

The life insurance industry is essentially regulated under two pieces of Commonwealth legislation, the Life Insurance Act 1995 and the Insurance Contracts Act 1984.

The Life Insurance Act 1995 regulates life insurance companies in their business operations, prudential standards and the sale and closure of life insurance companies. It enables the supervision by the Australian Prudential Regulation Authority (APRA) and the Australian Securities and Investments Commission (ASIC).

APRA supervises and regulates the prudential practices of life companies, including design and management standards and practices. ASIC's role is to ensure consumer protection by upholding market integrity and advisor conduct and insurance product sales and advice.

Laws relating to life insurance were originally within the powers of the states but were transferred to the Commonwealth government in the 1930's culminating in the Life Insurance Act 1945. That Act was updated and replaced by the Life Insurance Act 1995 which included legislating supervision by the recently-created APRA and ASIC.

For its part, the Insurance Contracts Act 1984 was enacted following a Law Reform Commission report into insurance law in 1981. The Act regulated the sale, renewal and cancellation of insurance contracts and the terms and conditions of those contracts, and also imposed obligations and minimum standards on the contracting parties. It applied to both life and general insurance to varying degrees. In 2003 the Milne-Cameron Review made recommendations for reform, many of which eventually found their way into the amending Act of 2013.

In addition to the above, most life insurers are members of the Financial Services Council (FSC), the peak body for many financial services providers. The FSC sets standards for member behaviour and has an oversight committee which can deal with complaints against members.

The life insurance industry was also subject to a voluntary code of practice in 1995. However, the code was not really embraced by the industry and like its little sister, the 1988 HIV/AIDS Life Insurance Code of Practice, it fell into disuse within a few years.

However, following recommendations of a report into life insurance sales practices by ASIC in 2014 and a subsequent industry-sponsored inquiry by John Trowbridge, the new Life Insurance Code of Practice was launched in October 2016. The Code includes the establishment of a life insurance code compliance committee to oversee the life insurance industry's compliance with the Code. The Code is due to commence in July 2017.

The new Code does not cover group insurance sold through superannuation which currently accounts for approximately 70% of all life insurance sold in Australia. This has been recognised by the superannuation and insurance industries and they have established an Advisory Council of stakeholders to develop a complimentary code or standards which would presumably include alignment with the new life code compliance committee.

Oversight at the micro level at least also occurs from accountability for individual decision-making through the courts and the relevant external dispute resolution complaints schemes, the Financial Ombudsman Service (FOS) and the Superannuation Complaints Tribunal (SCT). FOS also has the power to identify and report systemic issues.

The above represents a maze of oversight of life insurance companies. Of particular relevance to consumers is the oversight of life insurers' sales and claims practices and decision-making.

The Insurance Contracts Act 1984, by imposing duty of utmost good faith obligations on insurers, fettering policy terms and conditions and limiting insurers' rights to deny or vary claims, has proved to be an inspired piece of consumer protection legislation. The 2013 amendments have also improved and updated the Act and its consumer protection measures.

That said, there are some further reform measures which would further improve regulation of sales and claims practices.

For example, section 35 of the Insurance Contracts Act prescribes standard terms to various contracts of insurance consistent with public perception of what would be covered and what would be excluded under those contracts. Insurers have the ability to deviate from the standard terms and conditions but in doing so must "clearly inform" the insured of the deviation.

Standard cover, as it is known, has never applied to life insurance. Given the recent outcry over the application of fine print in certain life insurance contracts and the use of outdated definitions in trauma insurance claims, we submit that the same sound policy reasons behind standard cover apply to life insurance. Therefore the Insurance Contracts Regulations 1985 should be amended to develop standard cover life insurance policy terms and conditions.

At the same time, the wording of "clearly informed" in Section 35 of the Act needs to be updated to acknowledged that the inclusion of non-standard terms and conditions in a policy document is not sufficient to clearly inform a consumer of these terms. Experience shows time and again that consumers do not read and take in the wording of 20-50 page policy documents which they see as impenetrable. The recent use of key features statements to inform consumers whether they have flood cover in general

insurance home and contents policies is a good template to use to ensure that insureds are clearly informed of non-standard terms and conditions.

With respect to oversight, the biggest enhancement will likely come from a life insurance code compliance committee equipped with substantial powers of audit and sanctions to ensure and enforce compliance with the Code obligations.

The terms of reference of the committee have not yet been published and it will be important to ensure they are robust. It will also be important to ensure that the proposed complimentary superannuation arrangements which are due to commence on 1 January 2018 are substantial and robust.

ASIC and APRA have key roles to play to ensure the proper functioning of the life insurance industry. Their performance has been rightly put under the spotlight over recent years both in the media and in parliamentary inquiries following a number of high profile scandals.

ASIC in particular has been criticised for being too slow to identify and respond to problems in the industry. A lack of resources has often been identified as a key reason for this. In that regard, the increase in funding for ASIC in the 2016 Federal Budget was very welcome and hopefully this will lead to improved oversight of the sector and greater pre-emptive action.

It will also be relevant to await the outcome of the EDR Review by the Ramsay Committee, which may make recommendations as to the composition and powers of EDR schemes, including FOS and the SCT. The Committee is due to report by March 2017.

2. Assessment of relative benefits and risks to consumers of the different elements of the life insurance market, being direct insurance, group insurance and retail advised insurance

The benefits and risks of the three sectors of the life market are many and varied. Each has characteristics which affect underwriting, product tailoring, guaranteed renewability, scope and level of cover, information availability and price.

Each has its advantages and disadvantages, some of which are summarised below:

Direct insurance:

- no or limited underwriting
- limited scope-usually exclude pre-existing conditions and may have broader exclusions and limited definitions of injury/sickness and disability
- no individual advice or tailoring of products
- limited information- only online sales documents and PDS's
- retail-priced premiums-but often relatively cheap because of the limited scope

Group insurance

- no or limited underwriting up to Automatic Acceptance Limits

- broad scope-usually include pre-existing conditions, have limited exclusions and standard definition of injury/sickness disability
- no individual advice-default products not tailored and subject to opt in/opt out options
- reasonable information-online PDS's, annual statements and brochures and access to telephone advice but limited access to policy documents
- wholesale-priced premiums-traditionally significantly cheaper than retail

Retail advised insurance

- full individual underwriting
- limited scope-many pre-existing conditions are excluded, although often broad definitions and limited general exclusions subject to underwriting
- full individual advice and tailoring of products
- detailed information-access to policy documents, annual statements and ongoing advisor services
- retail premiums-traditionally the most expensive although the gap with group life premiums has narrowed in recent years.

From a consumer's perspective, important measures of the benefits of life insurance include the ability to obtain cover, the return on claims per premium dollar (loss ratios), the success rate of claims and the ability to understand the product being purchased.

On most measures, group insurance compares favourably. Most cover is offered on an automatic acceptance basis, the loss ratios of TPD claims for example are up to 90% and the group insurance policies tend to be relatively uncomplicated as they are generic and not tailored.

There have been questions raised recently about rejected group life claims although the high loss ratio figures would tend to indicate that consumers have successfully claimed benefits under group policies.

It has also been said that default insurance cover offered by superannuation funds on an opt out basis is poorly targeted, particularly to younger people who do not have dependents and therefore do not need death insurance cover. Whilst this is true of default death cover for younger workers, it is not true with respect to disability cover for young people or for the rest of the working age population, particularly given the chronic under insurance problem in Australia.

As the 2013 KPMG report and the 2014 and 2016 Rice Warner reports detailed, there is clear evidence that Australians are significantly underinsured with respect to their insurance needs. The 2016 Rice Warner report 'Underinsurance in Australia' found that the median underinsurance gap between the amount of cover required and the amount actually held was 63% for income replacement, 87% for Total and Permanent Disability (TPD) and 84% for income protection insurance.

The same authors specified in their 2014 report that the proportion of total life insurance held within superannuation funds was 71% for death cover, 88% for TPD cover and 59% for income protection cover.

There is no doubt that group insurance, particularly within compulsory employment superannuation, has provided millions of Australians with access to death and disability insurance cover that they would otherwise not have obtained. For many people with existing ailments, group insurance has represented

the only means of obtaining anything like adequate insurance to meet their needs if their working lives are cut short because of disability or death.

Insurance within superannuation provides a top up to a person's accrued superannuation with the aim of providing the person with an adequate retirement income. It is consistent with the stated aim of superannuation to provide an adequate retirement income, which is acknowledged in the Superannuation Industry (Supervision) Act 1993 by reference to the sole purpose test for death insurance cover and the ancillary purpose test for TPD and income protection cover.

There are undoubtedly improvements that need to be made as to how and what group insurance is offered in superannuation but it has operated as a very efficient means of delivering life insurance to Australians and any significant movement away from the current model and in particular the MySuper opt out model would have huge adverse implications for the availability of affordable life insurance, drastically reduce the amount of Australians who have life insurance and significantly increase the level of underinsurance in Australia.

The above analysis does not mean that direct and retail advised insurance do not have their place in the life market. To the contrary, they play very important and complementary roles and provide consumers with choices and the ability to increase their life insurance cover.

All three elements of the life insurance market must be nurtured and promoted if we are to address the underinsurance problem in Australia. The failure to do so will only increase the burden on the Australian taxpayer as people who do not have adequate insurance to meet their daily needs following adverse events such as disability or death would inevitably become reliant on the social welfare system.

3.Whether entities are engaging in unethical practices to avoid meeting claims

There is no doubt that insurers have rejected claims that should have been accepted. This is clearly illustrated by the many decisions to reject claims being overturned by FOS, the SCT or courts over the years.

There have also been some occasions where rejections or delays in claims appear to have followed a pattern or indicated a general tightening of claims processes or eligibility.

Some of these may constitute systemic problems although it is unclear whether there is evidence of widespread unethical practices to avoid meeting claims. The recent ASIC report "Life insurance claims: an industry review" did not identify "cross-industry misconduct" but it did note significant differentials in claim denial rates between insurers and across different types of products.

All insurers have claims manuals which prescribe how claims are to be assessed, including information and documentation required, timelines, communication with claimants and dispute resolution. In our experience, claims manuals have sometimes operated as a blunt instrument to delay claims, the most common complaint in claims management.

Claims manuals are not part of an insurance contract and the details are often unknown to consumers. Yet insurers rely upon them to assess claims with some adopting an overly technical and officious

approach which is not consistent with the insurer's general obligations. To make claims process more transparent and open to public scrutiny, claims manuals should be published on insurers' websites or in a format accessible to claimants. This would reduce the level of consumer dissatisfaction and reduce allegations of unethical practices.

Many allegations of unethical practices in claims processing could be addressed under the new Life Insurance Code of Practice and dealt with by the proposed code compliance committee. To the extent to which such alleged practices occur under group life policies held by superannuation funds, such corrective action will be dependent on the development of a complimentary code

4.The sales practices of life insurers and brokers, including the use of Approved Product Lists

The ASIC report in 2014 shone a light on commission-based sales practices of life insurance brokers and advisors. The review of retail life insurance advice found that 37% of advice consumers received was inappropriate and did not meet their needs. High upfront commissions were identified as strongly correlated to poor advice, including switching advice.

The Trowbridge Report, commissioned by the life industry in the wake of the ASIC report, subsequently made a suite of recommendations including capping commissions, banning volume-based payments and soft dollar incentives, and limiting commissions paid on switching products.

Legislation to introduce commission caps is due to commence in 2017.

However, there remains the issue of vertically integrated advice and sales. The Trowbridge Report recognised that conflicted advice from related entities was a significant problem in life insurance sales.

The Australian life insurance market has undergone significant consolidation in the last 10 years and there are now only 13 life companies to choose from. The Trowbridge Report acknowledged the limited options but recommended that advisors' Approved Product Lists (APLs) should include at least seven of the 13 life companies.

APLs are a tool for advisors to recommend insurers and products that have been fully researched and supposedly represent the best available options for clients. However, questions have been raised about whether APLs have in fact been used by related advisor groups to promote life insurance products that are not necessarily in the best interests of clients or to herd clients to particular products for commission-driven reasons.

Although there is a robust independent sector of the life market in Australia, many advisors are aligned to life companies or associated banks and some retail superannuation funds are aligned with life insurers who provide group life products.

Rules to control vertical integration of life insurance and to ensure that advice and the selection of life insurance is based solely on the interests of insureds or group members are crucial. The recommendation of the Trowbridge Report to mandate a minimum number of insurance companies in

APLs will substantially dilute the ability to herd clients towards related entities for commission-driven motives and is an important step forward.

5. The effectiveness of internal dispute resolution in life insurance

Internal dispute resolution (IDR) has been a feature of life insurance since the introduction of the Life Insurance Complaints Service (LICS) in the early 1990s.

LICS was the forerunner to the Financial Industry Complaints Service (FICS) which in turn amalgamated with the Insurance Ombudsman Service (IOS) and the Banking Ombudsman to form the Financial Ombudsman Service (FOS) in 2008.

Under the terms of reference of each, a consumer must first attempt to resolve his/her dispute with the insurer before lodging an external complaint. The insurer has 45 days in which to resolve a complaint, failing which a complaint can be lodged with the external complaints scheme.

Across the financial services industry, IDR complaints processes are usually prescribed in the relevant industry code of practice to which each financial service providers subscribes. This was also the case with the 1995 Life Insurance Code of Practice but as detailed above, this Code lapsed nearly 20 years ago.

Whilst all life insurers have continued to operate IDR complaints processes since, their effectiveness has varied across the industry and suffers from a lack of prescribed rules under a formal code and scrutiny by a proactive code compliance committee.

The most common complaints against life insurers are claim delays, failure to provide information and documentation, poor decision-making and a lack of communication.

To have complaints dealt with quickly and efficiently is a hallmark of any IDR complaints mechanism, particularly if the complaint itself is about delay. However, it is our experience that despite the 45 day time limit for decisions on IDR complaints set out in the FOS terms of reference, decisions on complaints by life insurers routinely take longer than 45 days and in some cases six months or more. This simply compounds consumer dissatisfaction and damages the reputation of the life industry.

Further, a lack of communication during the complaints process and decisions that are often not supported with detailed reasons and documents (e.g. full medical reports rather than selective quotes from reports which justify the insurer's apparently entrenched position) also belie a rigorous review process and leave consumers with a feeling of not being heard.

Whilst these issues are not unique to the life industry, as consumer lawyers who represent people across the various financial industry sectors, it is our view that the IDR complaints process in the life industry has lagged behind other sectors because of a lack of a code of practice.

Accordingly, the launch of the 2016 Life Insurance Code of Practice is a very important step. The Code does put in place measures around timeframes on progressing and making decisions on claims, the provision of information and documentation, communicating progress with claimants, the giving of reasons and the IDR complaints processes.

However, an effective Code depends on by-in by the industry and a robust code compliance committee. The signs for both are encouraging but the proof will be in the results after the Code is due to commence in July 2017.

It is also important to note that group life insurance under superannuation has been subject to statutory IDR under Section 101 of the Superannuation Industry (Supervision) Act 1993.

That Act specifies that a trustee must have in place a mechanism to deal with complaints lodged by superannuation fund members and make decisions on complaints within 90 days. If a member is not satisfied with the response to a complaint, he/she can then lodge a complaint to the statutory external dispute resolution complaint scheme, the Superannuation Complaints Tribunal.

A significant number of Section 101 complaints relate to the payment of death, TPD, income protection and terminal illness insurance benefits with the claims processed in a loop between the trustee of a superannuation fund and the group life insurer.

Similar types of complaints arise in the group life setting, namely, claim delays, lack of communication and poor decision-making. Also, similar complaints about the complaints processes exist, with the exception that communication tends to be a little better with the involvement of superannuation funds both as to progress of a complaint and the decision on the complaint.

However, superannuation group life claims also suffer from a lack of a code of practice and the planned introduction of a complimentary code at the start of 2018 cannot come too soon for consumers.

A criticism of the legal profession has been that when they represent insureds in claims, they do not take IDR or EDR complaints mechanisms seriously and instead advise their clients to issue court proceedings with a view to increasing legal fees.

In our view, it is very important and certainly in the interests of consumers that they actively participate in the IDR complaints processes that are genuine review processes and at arms length from the original decision makers. Further, it is important that consumers are appraised by their advisors of their rights (if any) to pursue complaints to the relevant EDR schemes.

Again, the above ties in with robust IDR and EDR complaints mechanisms which have the confidence of consumers which is in turn supported by robust and well-funded insurance and superannuation codes of practice.

6.The roles of the Australian Securities and Investments Commission and the Australian Prudential Regulation Authority in reform and oversight of the industry

ASIC and APRA have played crucial roles in the administration and oversight of the life insurance industry since their creation in the 1990s.

In general, they have done a reasonable job in keeping the industry on a steady and sustainable footing without any major upheavals or market failures.

That said, as is detailed above, there have been justifiable criticisms, particularly of ASIC, in being too slow to identify and react to problems such as have been highlighted in the media in the last few years. Hopefully the extra funding will go some way to addressing this problem

APRA has also come in for criticism recently for failing to identify problems with group life insurance contracts negotiated within the MySuper framework. As was identified in a recent Fairfax report, some superannuation fund trustees have negotiated group life contracts with TPD benefits and definitions that are inconsistent with the definition of permanent incapacity in the Superannuation Industry (Supervision) Act 1993 and as such may be in breach of the MySuper legislation.

APRA have rightly expressed concerns in the last few years about the profitability of group life insurance due to adverse claims experiences and have worked with life insurers to take corrective action. However, they have been criticised for not ensuring that the recently negotiated group contracts are MySuper-compliant. This has potentially exposed superannuation fund members to the risk that they may not be eligible in the future for benefits because of unintended consequences or harsh definitions that are not consistent with those required by law.

This is a salutory reminder of the responsibility to ensure that the interests of consumers are paramount, something that none of us should lose sight of.