

**ALLIANZ AUSTRALIA INSURANCE LIMITED SUBMISSION**

**Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill**

*15 August 2018*

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**TREASURY LAWS AMENDMENT (DESIGN AND DISTRIBUTION OBLIGATIONS AND PRODUCT INTERVENTION POWERS) BI****LL 2018 (THE BILL)**

1. **ABOUT ALLIANZ AUSTRALIA INSURANCE LIMITED**

Allianz Australia Insurance Limited is one of the nation’s largest insurers, with more than 4,300 employees, a combined premium income of more than $4.5b and assets of approximately $7.5b. The company provides insurance to more than 3.5m customers and workers’ compensation insurance to approximately 25% of Australia’s workforce.

1. **SUMMARY OF SUBMISSION**

Thank you for the opportunity to provide a submission on the further draft Bill which proposes to implement new:

* design and distribution obligations (DDO); and
* product intervention powers (PIP).

It is important to note up front that the proposed changes seek to deal with important matters worthy of consideration and which Allianz has already started to embed in our business. For example as part of our product governance framework, we seek to understand whether a product satisfies the needs of customers in an identified target market with particular emphasis on making sure that our products do not unfairly target vulnerable customers. This process has already started to deliver some benefits for our business but it has also revealed some challenges.

Central to our own learnings and the proposed changes is how we can best establish an appropriate Target Market Determination (**TMD**). We have found this to be a complex matter and in order to gain the most benefit from the proposed changes, it would be beneficial to have greater clarity on this before the legislation commences.

Clear guidance as to how to assess the target market for a product so that distribution conditions can be created to comply with the requirement (**Appropriateness Test**) is critical to ensure that if the product was issued:

* in accordance with the distribution conditions to a retail client – it would be likely that the retail client is in the target market; and
* to a retail client in the target market – it would likely be consistent with the likely objectives, financial situation and needs of the retail client.

Having a level of consistency in application of this change across the industry as a whole will ensure that all consumers benefit from the proposed changes.

Guidance would be best provided in the Explanatory Memorandum (EM) and by regulation setting out the level of cover for each type of product.

Package policies provide a particular challenge for our business and having further clarity on how package policies are to be treated in the operation of the above Appropriateness Test will be key to a successful implementation of the changes.

The obligations are proposed to apply at renewal. Although the transition period has now been extended to two years, given the uncertainty and requirements to implement new systems for renewals, we request that consideration be given to a staged implementation for new business versus renewals eg two years for new business and at least three years for renewals. By staggering the rollout for renewals, it enables customer feedback to be incorporated into the target market determination and processes and learnings to be bedded down and simplified, ultimately delivering better customer outcomes.

A final point of note is that there is significant review of the insurance industry at this time through the Royal Commission and other Government proposals regarding disclosure, standard contracts and definitions and unfair contracts. The findings from these forums may impact the detail of some of the proposed changes and we encourage a holistic approach to change across these.

Given the above, we recommend that before the Bill is introduced, further consultation occur on the detail that would reasonably allow industry, regulators (ASIC and APRA) and Government to:

* identify what obligations are and are not appropriate in the context of other reforms; and
* undertake a further cost benefit analysis; and
* determine an appropriate transition period.

Below we provide further detail on other Key Issues in this submission.

1. **KEY ISSUES**

**Type of insurance product caught**

Relevant to insurance, the Bill requires a person to make a target market determination TMD for a financial product if, under Part 7.9 of the Corporations Act, the person is required to prepare a Product Disclosure Statement (**PDS**) for the product.

This clearly covers products that are wholly home buildings, home contents, motor, consumer credit, travel, personal effects.

*Packaged policies*

For insurance containing a number of different covers within a single contract (some within the retail client product definitions and some not), the PDS requirements are typically considered to only apply to the retail cover part of the contract not the whole contract – See s 761G (5) and regulations. For example ‘Regulation 7.1.12:

For subparagraph 761G(5)(b)(ii) of the Act, a home building insurance product is a contract **or part of a contract** that provides insurance cover (whether or not the cover is limited or restricted in any way) in respect of destruction of or damage to a home building.’ [our bold]

Because these policies contain retail covers the whole policy wording is prepared as a PDS.

An example is Farm Pack which contains home and contents and domestic motor insurance as well as non-retail products such as Public and Products Liability and Farm Property cover in the one PDS.

Clarification is required as to the intent in relation to these policies. It is not clear whether the intent is for the TMD obligations to apply to *all* covers ie the retail and non retail covers.

If both, insurers will need to create separate offerings ie offer retail covers separately from the wholesale covers. This would require extensive and very costly modifications to systems resulting in substantial costs to the insurer and complexity for consumers. In addition, purchasing the component covers separately could further increase the cost to customers.

In terms of Stop Order powers, content in such packaged PDSs are likely to need to be separated to mitigate the risk of all covers being stopped by reason of a failing in a retail component.

**Issues related to making a TMD - s994B(5)**

As the Bill is currently drafted, it is unlikely that insurers will be able, with any certainty, to determine how they can reasonably describe the class of retail clients that comprises the target market for the product. Insurers will therefore take different approaches, generating inconsistency across the industry and creating confusion for customers.

While we understand that a level of granularity is required to successfully identify a target market, for example, for a motor vehicle insurance product, to be more detailed than just “anyone with an insurable interest in a motor vehicle”, there is no guidance in the draft Bill or explanatory memorandum (EM) around the expectations of the level to which insurers must go for mass market products that are suitable for broad categories of consumers.

As an example, a stakeholder view was expressed at a recent consultation, that included Treasury and ASIC, that the target market for motor vehicle insurance must go to the level of those consumers who should have a specific type of excess. This would appear to take granularity to the extreme and a more pragmatic approach is recommended.

A practical example explaining the issues for a motor insurance product is provided in the Appendix at the end of the submission.

We would also encourage inclusion of the concept scalability when defining the target market. The Financial System Inquiry recommended that such obligations be scalable depending on product complexity. The aim was for compliance to be straightforward for simple products that are likely to be suitable for most consumers. The retail classes of general insurance (other than medical indemnity insurance) are examples of such simple products.

Due to the unique nature of general insurance, we support special guidance/rules being included in the legislation as well as the EM. It is currently common practice in the Corporations Act to include provisions specific to insurance and that are separate to investment and other financial products. Regulation making power could be added and the regulations could specify the level of cover for each retail product.

Where there is a lack of clarity, insurers may be forced to go to a compliance level that will either result in more limited product offerings or more expensive insurance or both. Systems change costs can be significant depending on the level to which a target market must be determined.

We suggest that this guidance be provided, if through draft regulation or otherwise, as soon as possible, preferably before introduction of the Bill. Alternatively we suggest that any transition period not commence until the regulations are made or the guidance is otherwise provided.

Consideration should also be given as to whether certain core products (e.g standard cover such as motor and home insurance) should be excluded from the requirements and the standard cover reforms (yet to be progressed) used to achieve reasonable and cost effective protection.

**Distribution conditions issue**

Without clarity on how to determine the target market, the requirement to specify any conditions and restrictions on retail product distribution conduct to ensure the TMD is appropriate and the product is sold to the correct persons (**distribution conditions**), cannot be easily determined.

The distribution conditions must be designed to ensure the insurer can satisfy s994B(8) (the appropriateness test – see below), that is, that it would be reasonable to conclude that if the product is issued to a retail client in accordance with the distribution conditions, that person would be in the target market described in the TMD.

The issue is the determination of who “would be” in the target market. Without knowing where the target market line is drawn, this is difficult to define. For example, if the target market for a motor policy is a person with a car, the distribution conditions are relatively simple, for example, it could be achieved by building in a knock out question preventing the issuing of a policy where the person does not own a car.

If different car owners have to fit into separate target markets for each type of relevant cover, excesses etc (see the example in the Appendix to this submission), the distribution conditions become more complex as insurers need to add more distribution conditions (and knock out questions) to ensure the product is not issued to someone who does not fit the target market criteria for the relevant type of cover and so on.

We support the definition being practical and pragmatic, defined at a higher level of granularity. Otherwise, the level of detailed distribution conditions to achieve this could be very complex and TMDs would be very long and contain detailed underwriting rules. This might result in confidential or commercially sensitive underwriting information being made available to competitors.

We also note that we cannot know a customers’ needs with any certainty and the legislation should not be so restrictive as to prevent customers having access to a product that they need. For example, despite being a non-target, a person may want the product for reasons specific to their circumstances. An insurer may have no knowledge of these circumstances and by restricting their choice, they don’t receive the protection that is needed.

Because there are strict liability offences associated with compliance with the obligation, insurers will be forced to take a conservative position on who comes within their target market and the distribution conditions. This could lead to some customers being unable to obtain insurance that may in fact be of value to them.

A practical balance between defining target markets an ensuring customers’ needs are met is critical.

A reasonable and fair safe harbour concept needs to be built into the legislation.

**TMD Appropriateness test** - **s994B(8)**

In relation to the appropriateness of the TMD as proposed, there are two major issues. A TMD must be such that it would be reasonable to conclude that, if an issue, or a regulated sale, of the product were to occur:

* ***in accordance with the distribution conditions to a retail client—it would be likely that the retail client is in the target market.***

As noted above, unless you can clearly determine the target market (which is not reasonably possible for insurers based on the proposed wording) an insurer will have no certainty regarding this obligation. Significant civil and criminal penalties apply if a TMD is not appropriate;

* ***to a retail client in the target market—it would likely be consistent with the likely objectives, financial situation and needs of the retail client.***

This applies so that the distribution to retail clients in the target market would result in consistency with the objectives, financial situation and needs of “*the* retail client” (ie the individual) being met – this is not possible.

We assume that the intent is that the retail client buying the product at least has the identified objectives and needs of the retail client target market the insurer is seeking to meet in the product offering, that is, they come within the defined target market. This second requirement needs to be corrected in light of this.

As noted above, without clarity about the expected level at which the TMD should be set, it is not possible to easily determine the distribution conditions that would allow for this appropriateness test to be met and it is not possible to specify events and circumstances (ie review triggers) that would reasonably indicate that the TMD is no longer appropriate. The same issues apply to all other content requirements of the TMD.

**New Business Issue**

Assuming a target market requires a more complex breakdown of who is within and outside a relevant target market, this would require insurers to ask a significant number of knock out questions (ie distribution conditions) which could significantly increase the length of the sales process.

This would add to the length of time and costs of purchase of what are essentially commoditised insurance products. This could result in a poor customer experience, increased drop-out rates and increased levels of non insurance, which is an acknowledged issue for the community.

Practically a higher level target market will enable a stronger customer experience.

**Renewal Issue**

Treasury has advised that the Government position is that the TMD obligations will apply on renewal of each customer’s policy.

Many insurers that issue retail insurance that is renewable (eg car, home, contents, sickness and accident etc), agree with insureds on an automatic renewal process. For customers that pay by instalment, a renewal invitation is given to them at least 14 days prior to renewal (usually longer), attaching the schedule for the new period of insurance. Unless otherwise advised by the customer, the insurer offers renewal and will automatically renew the policy on the terms offered. In some cases, the insurer relies on a non response from the insured as confirmation that no changes to disclosed circumstances have occurred that may impact the risk. There are real benefits in this process for insureds in terms of cost savings and reduced risk of being left uninsured.

If a new obligation is imposed on insurers to vet all renewals against distribution condition knock outs, this would have a significant cost impact on insurers (with significant systems and process changes required) and ultimately increase the price of insurance for consumers and their insurance broker representatives. Customers would potentially have to contact the insurer, either by telephone or through a web portal so that the insurer can reaffirm whether they are in the target market. If they fail to do so, their policy would lapse and they will be left uninsured.

The impact of the above on renewal business is significant for policies issued pre commencement of the new obligations. The insurer would need to build in special renewal distribution conditions to ensure the person renewing is in the target market and, if not, decline to renew their policy even if the policyholder wished to renew.

The TMD rules will ultimately lead to significant additional imposts on consumers in the renewal context as insurers are required to make significant systems changes and adopt an approach contrary to the Government’s existing renewal approach under the Insurance Contracts Act.

We suggest that a mechanism be included so that an insurer can inform the customer of who is in the target market and the record of previous answers to any questions used to assess whether the customer came within the TMD. If the customer does not advise the insurer that anything has changed, they will be deemed to still be in the target market.

This is similar to one of the methods that can be used by an insurer to comply with the renewal duty of disclosure under s21B of the Insurance Contracts Act. It was deemed appropriate for that form of consumer protection in 2015 and achieves a fair balance.

This is an issue specific to insurance and there is no apparent reason why this could not be included in the legislation. There is precedent for this as many provisions of Chapter 7 of the Corporations Act are specific to insurance.

Systems changes to implement this mechanism are likely to cost around $15 million for Allianz alone. If this mechanism was not implemented, the ongoing costs to insurers of having the customer contact it could cost significantly more. More burdensome alternatives to the above proposal would be even more costly, which would have to be passed on to consumers through higher premiums.

**“Excluded dealing” issue**

Under s994E(3), where a TMD for a financial product has been made and the product is to be offered to retail clients and a regulated person:

* engages in retail product distribution conduct in relation to the product; and
* has failed to take reasonable steps that would have resulted in, or would have been reasonably likely to have resulted in, the retail product distribution conduct being consistent with the determination,

the regulated person will be in breach unless the retail product distribution conduct is excluded conduct. Excluded conduct includes “excluded dealing”.

The carve out for “excluded dealing” only applies if arranging by a person is for the purpose of implementing personal advice that the person has given to the retail client. This does not take into account the situation where a customer has been given information about two or more products and received personal advice recommending product A, but the client wishes to purchase product B despite the personal advice? This scenario should be built into excluded dealing or an insurer would be unfairly exposed, for example, where the client has received personal advice, but the broker arranges on the client’s instruction a product of the same type that wasn’t recommended.

1. **OTHER ISSUES**

**Record keeping and reporting -**  **s994F and s994G**

In terms of the record keeping and reporting obligations of issuers and regulated persons:

* until the TMD requirements are made clear, it is difficult to comment on how this will impact on insurers. It will, however, be costly for the insurer and increase costs to the consumer.
* the record keeping and reporting requirements do not take into account that there may be more than one regulated person, for example, in a coinsurance arrangement, and may result in unnecessary duplication of records and reporting.
* the reporting requirements on regulated persons apply to brokers acting for insureds, including when providing personal advice, and could create a conflict of interest or a breach of confidentiality when reporting to insurers;
* the 10 day period in which reporting is required is very short;
* we note the obligation on a regulated person to report to the issuer of the TMD where they engage in retail product distribution conduct in relation to the product and they become aware of a significant dealing in the product that is not consistent with the determination. Brokers providing personal advice are carved out from the retail distribution conduct obligations. If this results in clients purchasing products outside the TMD, it is not clear why such regulated persons to report this to the insurer. It can also give rise to conflicts of interest and breaches of confidentiality if the information reported may not be for the benefit of the customer;
* what is a significant dealing is unclear and will create confusion. Is the word “dealing” meant to be interpreted as defined in the Bill or as a general concept?

**TMD in PDS issue – s1013D(1)(f) of the Corporations Act**

It needs to be clarified in the legislation that the requirement to include information about any of the rights, terms, conditions and obligations attaching to the product does not constitute a requirement to include the TMD in the PDS.

Based on the proposed obligations, the TMD is likely to be a large document with the content requiring continuous review, record keeping and, potentially, amendment.

Requiring the TMD to be included in the PDS would make that document more confusing and would require the insurer to update the PDS every time that the TMD changed. As many insurers have multiple PDSs, this would be at a significant cost.

In addition, if the TMD only applies to the retail covers in a package policy (see above), including the TMD in the PDS would make the document confusing. Confirmation should preferably be included in the legislation, otherwise in the EM or via ASIC.

**Section 1018A - advertising**

Section 1018A is proposed to be amended to require description of the target market for the product in advertisements or to specify where the determination can be found. This will extend what are already lengthy prescribed advertising notices even more and add to compliance costs. This is unnecessary given obligations regarding the protection in the TMD rules at point of issue. Lengthening the prescribed notices could take away from important information in advertising seeking to point out any relevant qualifications about the product as a result of there being a larger amount of text, for example, on the TV screen or a longer oral disclaimer on a radio advertisement.

**Suitable - paragraph 760A (aa)**

Use of the word suitable in paragraph 760A(aa) with respect to the intent of the legislation, will in our view cause consumers to be misled because it creates a higher and incorrect expectation (akin to a personal advice expectation) than that the Bill seeks to achieve. The plain meaning in the dictionary of suitable is “right or appropriate for a **particular** person, purpose, or situation.” [our emphasis]

**Allianz Australia Insurance Limited**

**Appendix**

**Practical example of the issues with describing the class of retail clients that comprises the target market for the product**

***Standard motor vehicle policy.***

There are three main type of cover choices offered to customers:

***Main type of cover choice***

* Comprehensive cover – the highest level of cover covering the vehicle for accidental loss or damage and the insured’s liability to third parties;
* Third Party Property Damage insurance – only provides liability cover for the insured’s liability to third parties;
* Third Party Fire and Theft insurance – covers accidental loss or damage to the vehicle caused by fire or theft and the insured’s liability to third parties.

***Secondary choices***

After identifying the ‘main type of cover’ option, a customer then needs to consider things such as:

* which level of cover is suitable for them eg agreed vs market value and the limit of liability (if optional);
* whether the automatic additional benefits included are suitable for them;
* which optional benefits are suitable for them;
* whether any default excess level is suitable for them or if excess options are available, which options are suitable for them;
* whether the conditions are suitable for them;
* whether the exclusions that apply are suitable for them; and
* whether the cost is suitable for them and how they should pay – annually or by instalment.

An insurer cannot advise which of the above choices might be suitable without providing personal advice as the choice will depend on the customer’s personal circumstances. Personal advice is not normally provided by insurers.

At the ‘main type of cover’ level of choice, the target market at its highest would be anyone with a car. Is the intent that this is the level at which the target market can be set or is the expectation that an insurer must go further, and if so to what extent?

If the target market must be more than a person with a car, where is the target market defined? For example:

* A requirement to identify and define a target market for each main type of cover? Eg for comprehensive cover, a person with a car that wants/needs cover for loss and or damage to the car and cover for liability?
* A requirement to further identify and define the target market for the main type of cover and level of that cover, for example, agreed vs market value? Or an even further requirement to identify and define the target market for the main type of cover (eg comprehensive), the level of that cover (eg agreed vs market value) and also additional benefits and options, excesses, exclusions and conditions etc?

For example, for comprehensive cover, a person with a car that wants cover for loss and or damage to the car and cover for liability and a cover for accidental damage and:

* + additional cover comprising the provision of a rental car after theft;
  + optional cover comprising cover for use of the vehicle for rideshare purposes;
  + what excesses they should choose eg where nobody other than specified persons drives their car, should they choose a higher excess (currently $2,500 for Allianz direct policies);
  + conditions of a specified type – those in policy or in specified circumstances as some conditions may not apply to all insureds;
  + exclusions of a specified type or in specified circumstances as some exclusions may not apply to all insureds; and
  + whether the cost is suitable for them and how they should pay – annually or by instalment?
* Is it any person with a characteristic that makes them ineligible for the product, such as type of car, value of car, location of insured/insured item (and if so at what level eg State, area code, suburb)?

Depending on what is expected (which is unclear), this could make a TMD an extremely complex document and also provide competitors with commercially sensitive information and could potentially breach competition laws.