SUBMISSION

TO THE

FINANCIAL SYSTEM INQUIRY

NATIONAL INSURANCE BROKERS ASSOCIATION OF AUSTRALIA

31 March 2014

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INTRODUCTION

The National Insurance Brokers Association of Australia (NIBA) welcomes the opportunity to provide this Submission to the 2014 Financial System Inquiry.

In one sense, the Inquiry is about how Australia funds growth and prosperity, and from the commentary to date this will be an important part of the Inquiry's work.

However, economic activity, growth, and the accumulation of assets, brings with it risk. A key feature of the Australian financial system is the management and financing of risk. Insurance is a very important component of the risk financing process, and provides strong protection and security for individuals, small medium and large businesses, multi-national corporations, and public sector agencies and governments.

Overall, NIBA considers that Australia has been well served by the insurance industry in Australia, particularly since the implementation of the recommendations of the HIH Royal Commission. The sound performance of Australia's insurance industry during the global financial crisis when compared with foreign jurisdictions was good proof of this.

We believe it is important, however, to carefully reflect on the nature and effectiveness of financial services regulation in Australia and this Submission offers commentary and a recommended strategy for this important issue.

This Submission is in the following sections:

- About NIBA
- About Insurance Brokers
- The Financing of Risk
- The Insurance Industry in Australia
- Statutory and Mandatory Insurances
- Insurance Regulation and Self Regulation
- Insurance Taxes
- The Future

ABOUT NIBA

NIBA is the peak industry body for the insurance broking profession in Australia. NIBA represents around 400 member firms, and over 3,000 Qualified Practising Insurance Brokers (QPIBs) throughout Australia. In total, NIBA represents an estimated 90% of all insurance brokers in Australia.

NIBA –

- represents and speaks on behalf of its members to governments, Members of Parliament, regulators, the media and other interested stakeholders;
- promotes the professionalism of insurance broking through industry based training and professional qualifications (NIBA College) and through a strong, independently administered and monitored Code of Practice for members;
- communicates the importance of insurance and the role of insurance brokers to the community;
- provides a number of services to its members, including member communications and an annual industry Convention; and
- liaises with equivalent foreign associations through its membership of the World Federation of Insurance Intermediaries in order to help maintain high standards for its members on an international basis.

The 400 member firms all hold an Australian financial services (AFS) licence, issued by the Australian Securities and Investments Commission (ASIC) under the Corporations Act, which enables them to deal in and/or advise on risk insurance products and other facilities through which people may manage financial risk.

NIBA Members include large multinational insurance brokers, large Australian-owned insurance brokers, and around 380 small to medium sized insurance broker businesses located in the cities, towns and regions across Australia.

ABOUT INSURANCE BROKERS

The role of insurance brokers

The traditional role of insurance brokers is to:

- assist customers to assess and manage their risks, and provide advice on what insurance is appropriate for the customer's personal or business needs;
- assist customers to arrange and acquire insurance; and
- assist the customer in relation to any claim that may be made by them under their insurance program.

In doing the above the insurance broker acts on behalf of the customer as their representative or agent. Insurance brokers offer many benefits to customers and consumers, including:

- assistance with selecting and arranging appropriate, tailored insurance policies and packages
- detailed technical expertise including knowledge of prices, terms and conditions, benefits and pitfalls of the wide range of insurance policies on the market;
- assistance in interpreting, arranging and completing insurance documentation;
- experience in predicting, managing and reducing risks; and
- assistance with claims and the resolution of claims.

In limited cases insurance brokers may act as agent of the insurer (not the insured) but where such a relationship exists the customer is clearly advised up front.

For larger corporations, public sector agencies, governments and other sophisticated purchasers of insurance services, insurance brokers play a key role in assisting with identifying and managing risks, and with assisting the organisation finance risks via self-insurance, national and international insurance and reinsurance programs, or other risk financing mechanisms.

Insurance brokers handle around 90% of the commercial insurance transacted in Australia, and play a major role in risk assessment, risk financing and insurance distribution, handling over $18.4 billion in premiums in the 12 months to 31 December 2013[1], and placing around half of Australia's total insurance business. Insurance brokers place most insurance business with Australian authorised insurers, but also place substantial insurance business into Singapore, London and other overseas markets for large and special risks where the local markets are either unable to provide such insurance or provide it on unsatisfactory terms.

All insurance brokers in Australia must hold an Australian financial services (AFS) licence, issued by ASIC under the Corporations Act, which enables them to deal in and/or advise on risk insurance products.

[1] Source: Australian Prudential Regulation Authority, *Intermediated General Insurance Statistics*, December 2013, issued 5 March 2014, available at www.apra.gov.au

THE FINANCING OF RISK

The Inquiry's Terms of Reference are largely about the financing of growth and prosperity in Australia.

But very little growth and prosperity occurs unless the owners and financiers of that activity are able to obtain insurance, or insurance like products and services, on competitive terms. The insurance industry in Australia helps provide the security that allows individuals, businesses, large and multinational corporations and governments to undertake their normal activities.

Risk is faced by individuals in relation to the property they own, the liabilities they incur to others, and their financial security in being able to earn income, fund their lifestyle and fund their retirement.

Businesses face risk in their daily operations, whether it be the risk of property loss, business interruption, product liability, public liability, employer liability, directors and officers' liability, and so on.

Communities face risk through their exposure to natural disasters and catastrophes. These events often expose levels of uninsured risk in the community, with the potential for community disruption and permanent losses.

The growth and prosperity of Australia is therefore dependent on mechanisms by which risk is financed – whether by the transfer of risk via the insurance process, or other more sophisticated risk financing mechanisms adopted by larger corporations and governments.

NIBA believes it is important that any examination of the Financial System in Australia include in its work, a review of the financing of risk that is faced by individuals, communities, corporations and governments.

By and large, Australia is well served by the insurance and risk financing mechanisms commonly available across the community. Insurance is available for most areas of risk, from a range of APRA authorised insurance companies. As noted in the introductory comments, it is also possible for large, special and difficult risks to be insured in overseas insurance markets where required or appropriate.

Australia has over 3,000 qualified insurance brokers who are able to assist clients understand and manage their risks, assess the availability of insurance which can cover those risks, negotiate the purchase of insurance on their behalf, and effectively manage the making of any claims.

However, there have been occasions when the normal insurance markets have not been able to provide sufficient cover required by the community.

Following the September 11 attacks on the World Trade Centre in New York, and subsequent bombings in Bali, the risk of terror related events saw the gradual but almost complete withdrawal of insurance coverage for losses arising out of terrorist events. Property was able to be insured for other types of losses, but not for terrorism.

After careful examination of the issues, the Australian Government initiated the Australian Reinsurance Pool Corporation (ARPC), which effectively provides terrorism cover in the nature of reinsurance of property insurance policies written in Australia. This was a government response to a market failure, and a process was initiated whereby security could be provided in respect of commercial property in this country. Importantly, the terrorism pool was designed to be able to be withdrawn if and when the commercial reinsurance market was able to provide the necessary cover.

Today, there is substantial community concern regarding the limited supply and high cost of property insurance in North Queensland, particularly for many residences and for strata title properties. Only a small number of insurers are operating in that market, and the cost of insurance has risen substantially in recent years.

Many have called for some form of government intervention in the property insurance market to ensure cover is available and affordable across Australia, including in areas exposed to tropical cyclones and other severe weather events.

There have been similar calls for government intervention in the property insurance market to make flood insurance affordable for around 5% of properties that are susceptible to damage by flood. Recent experiences in areas of Queensland, including Brisbane itself, saw many calls for government intervention in this area.

To date, the general insurance industry has responded by including flood cover in most domestic insurance policies, but sometimes at a price that the property owner was not expecting or could not afford.

Australian weather, floods and fires are putting great pressure on the insurance process, and the concept of pooling of risk – which, after all, is what insurance is all about.

By and large, insurance pools the contributions of many to cover the losses of the few. For the majority of policyholders each year, they pay their premiums for the policies they purchase, they receive the promise of cover from their insurers, and nothing further happens. For the unfortunate minority, the insured loss occurs, and they call on the support and assistance of their insurance company to assist with the recovery of the loss and the restoration of their financial position.

The size of the insurance pool is determined by the number of contributors to the pool, and the value of the losses expected to be covered by the pool. The insurance premium is simply the expected value of claims divided by the number of policies, plus the costs of administration and a return on capital.

In some areas – Queensland floods and North Queensland storms are good examples – the value of expected losses has been growing markedly in the past 15 years, and will continue to grow. This requires the size of the insurance pool to grow to meet those expected losses, and if the number of policyholders does not increase, the level of premiums will. This is the reality in respect of flood, cyclone and storm losses in many parts of Australia.

The community does not accept ongoing increases in premiums which are otherwise required to fund the cost of claims being paid out of the insurance pool. Currently, there is substantial community concern about the cost of property insurance in many parts of Australia, particularly in Queensland.

Insurance cannot be the community's main method of managing and financing losses arising from natural and weather related disasters. A comprehensive insurance program will not protect against the sad and unfortunate loss of life which often accompanies major weather, flood and fire events across Australia.

Equally, the community cannot fund the increasing cost of damage that occurs during weather, flood and fire events. The level of premiums required to fund the insurance pool in many areas, especially in areas of high flood risks, simply cannot be afforded by those communities.

The Australian Business Roundtable for Disaster Resilience and Safer Communities has been formed by a number of commercial and community organisations "to champion the need for a more sustainable, coordinated national approach to make our communities more resilient and our people safer. It's the only way to reduce the future economic and social costs of the inevitable natural disasters Australians will face."[2]

It is widely recognised that there is a continuum of risk management:

- identify and assess the risk;
- manage, eliminate and/or reduce the risk to the greatest extent possible;
- assess the nature and extent of any residual risk; and
- finance the residual risk, either by risk transfer (insurance) or some other form of risk financing.

To date, most effort, and money, has concentrated on disaster response, recovery and restoration. The Australian Business Roundtable presents a compelling case for more effective management of risk, and a more cost effective approach to the financing of the risks faced by communities across Australia.

NIBA firmly believes that risk management and risk mitigation must play a far greater role in the future, in order to ensure the risks that need to be insured (or financed) can be done so at a cost the community can afford, and in a manner the insurance industry can viably manage.

At the end of the day, risk is financed in three ways:

- self insurance, whereby the individual, corporation or government (taxpayers) finance their own risks, thereby putting their own assets and income streams in jeopardy;

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[2] See: http://australianbusinessroundtable.com.au/

- risk transfer, whereby risks are transferred to an insurance pool, and the insurance pool and the insurer's capital carry and finance the risk; and
- community funding of risk and loss, which often occurs in Australia at the present time in respect of uninsured losses following natural disasters and other major events which affect numbers of people at the same time.

A modern society with a mature economy such as Australia should be entitled to assume that risks are being properly managed and mitigated, and that the financing of risk is operating in an optimum manner, for the benefit of all. [3]

[3] NIBA notes that on 20 December 2013 the Federal Government announced its intention to give a reference to the Productivity Commission to examine the financing of natural disasters in Australia

THE INSURANCE INDUSTRY IN AUSTRALIA

Insurance products and services in Australia are generally categorised as either life insurance or general insurance.

Life Insurance

BACKGROUND

Life insurance in Australia is highly concentrated, with the top three life insurers holding 76% of industry assets as at 30 June 2013[4]. The top 10 companies manage 96% of assets. Based on direct regular premium revenue, life insurance is less concentrated, with the top 6 insurers (out of 22 direct writers) writing 75% of the industry premium over 2012/2013.

Life risk insurance business normally falls within three categories:

- individuals take out life insurance, disability insurance and/or income protection insurance, through a life insurance broker, a financial adviser or directly from an insurance company or its agent;
- groups – normally employers – arrange a group policy, and offer or provide the cover to the members of the group (such as employees of the company), with terms and conditions of cover being arranged via a life insurance broker or a financial intermediary; or
- life insurance, disability cover and/or income protection insurance is purchased through a person's superannuation fund.

Life risk insurance products may be purchased either individually, or as part of a financial planning and investment strategy.

If a life insurance broker is involved, the client will receive advice in relation to the risks that should preferably be insured against (including income protection risks), and will be recommended relevant products to help meet those risks.

If life insurance is purchased in some other manner, or directly from an insurer, there may be little or no advice offered to the client, and they may simply be recommended a product that may or may not meet their circumstances (this is general advice, not personal advice). Concerns have been

[4] Background information in this section is taken from the APRA publication *Insight*, Issue 3, 2013, available at www.apra.gov.au

expressed regarding the sale of life risk insurance products that may not be in the best interests of the customer, once all relevant circumstances have been taken into account.

ISSUES AND CONCERNS

The APRA publication *Insight*, issued in 2013[5], sets out a number of issues and concerns in relation to the pricing, profitability and trends in life risk insurance in Australia at the present time.

It would seem that generous cover has been provided, either through group insurance plans or by superannuation funds, with little or no underwriting of the risk associated with the cover being provided. Incorrect pricing leads to inevitable problems in later years, the most obvious example of this being the failure of HIH Insurance group. Here, the Royal Commission found that the most important cause of the company's failure was the loose underwriting and pricing policies adopted within the company, with little or no regard to the true nature of the risk that was being insured.

There have also been concerns expressed by ASIC representatives regarding the influence of commission and remuneration structures in life risk insurance[6]. The Future of Financial Advice reforms were intended to address some of these concerns, but the content of those reforms is subject to change as this submission is being prepared.

General Insurance

THE NATURE OF THE GENERAL INSURANCE MARKET IN AUSTRALIA

The general insurance market in Australia has changed dramatically in the past 15 years. With a number of mergers and acquisitions in the late 1990's, the failure of HIH Insurance in 2001 and strong prudential regulation by the Australian Prudential Regulation Authority (APRA) since 2003, the market has come to be dominated by a number of insurance groups.

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[5] APRA *Insight*, Issue Three, 2013

[6] See speech by ASIC Deputy Chairman Peter Kell to the Money Management and Financial Services Council Breakfast Series, 12 March 2013, available at: http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/speech-FOFA-and-the-new-reality-PeterKell-published-13-March-2013.pdf/$file/speech-FOFA-and-the-new-reality-PeterKell-published-13-March-2013.pdf

Nevertheless, the insurance market in Australia, by and large, remains very competitive, innovative, and strong.

Following those developments, NIBA now regards the categorisation of insurance markets as follows:

1. Direct insurance markets: these include insurance sold directly by insurers via branches, call centres and the internet, insurance sold by insurer appointed authorised representatives/agents, and insurance sold through a wide range of commercial distribution arrangements (for example, National Australia Bank sells a range of general insurance products on behalf of Allianz, and Woolworths sells a range of general insurance products on behalf of The Hollard Insurance Company).

   NIBA understands the majority of domestic insurance (home buildings insurance, home contents insurance, private motor car insurance, motor vehicle CTP insurance, travel insurance, consumer credit insurance) is sold via the direct insurance markets.

   In addition, some small business and commercial insurance is also sold via direct insurance markets.

2. Intermediated insurance markets: insurance products are arranged via intermediaries, invariably insurance brokers and authorised representatives of insurance brokers, acting on behalf of the client and not acting on behalf of the insurer. (Where an insurance broker arranges insurance on behalf of an insurer, and acts on behalf the insurer as its agent, it falls within the first category and where this occurs the relationship is made clear to the client.)

   NIBA understands the majority of commercial insurance for small, medium and large businesses, large corporates, governments and international corporations, is arranged via the intermediated insurance market. Insurance intermediaries also arrange domestic insurance, although as noted above the majority of domestic insurance is arranged via the direct insurance market.

   Insurance brokers place business mostly with insurance companies authorised and regulated by APRA (this includes Lloyd’s). Insurance brokers also place insurance business with overseas insurers in the case of large and special risks.

   Almost half of the general insurance business in Australia (by premium) is placed via insurance intermediaries (including both business placed in Australia and business placed overseas).

   Details of business placed via the intermediated insurance markets can be found in the APRA publication *Intermediated General Insurance Statistics*, the most recent being dated 31 December 2013, issued on 5 March 2014, available at www.apra.gov.au.

The direct insurance market is now essentially a national market, dominated by brands associated with the IAG Group and the Suncorp Group. There remain some State based insurers (for example RACQ in Queensland, RACT Insurance in Tasmania), but the majority of business is now placed with insurers operating on a national basis either under their own brands or via commercial distribution arrangements.

Despite the dominance of the direct insurance market by IAG and Suncorp, there has been an increasing amount of activity in this area by the major banks (Commonwealth, Westpac and ANZ via their own insurance companies, NAB as agent for Allianz), the two major supermarket chains (Coles, underwritten by Wesfarmers General Insurance (the Wesfarmers insurance business is currently the subject of a takeover offer by IAG Group, which will not be opposed by the ACCC but the takeover remains subject to further regulatory approval); and Woolworths, underwritten by The Hollard Insurance Company) and by smaller players attacking the market via the internet.

The intermediated insurance market has a larger number of active insurers and underwriters, giving insurance brokers and intermediaries (and their clients) a range of markets – in Australia and overseas - in which to operate. In addition to the commercial insurance arms of IAG Group (CGU) and Suncorp Group (Vero), brokers currently place business locally with QBE, Allianz, Zurich, Wesfarmers General Insurance (including Lumley), ACE, AIG, Chubb, Lloyds and others. As noted previously, large, special and difficult risks can be and are regularly taken to the world wide insurance markets, with the majority of this business being placed in Singapore and London.

THE GENERAL INSURANCE MARKET TODAY

The importance and strength of the general insurance industry in Australia today is evident from the following.

The global financial crisis seriously affected the balance sheets of many corporations world wide, particularly in the financial services sector. During the global financial crisis, APRA authorised general insurers remained viable, well capitalised, and profitable. They continued to honour the promises set out in the insurance policies they had written.

Towards the end of the global financial crisis (2010 – 2012), Australia experienced a number of major weather and natural disaster events, with insured losses extending well above $7 billion during that period.

Once again, the general insurance industry in Australia remained viable, well capitalised and strong. Billions were paid to or on behalf of policyholders, and substantial funds were received by Australian authorised insurers from the world wide reinsurance market to support the payment of claims by local insurers.

The insurance industry has continued to perform its function, and honour its commitments, during more recent, and thankfully less severe, fires, storms and floods.

APRA has reported that the general insurers it supervises met prescribed capital coverage requirements 1.88 times as at 31 December 2013[7]. In other words, general insurers currently maintain 1.88 times the prescribed prudential regulatory capital requirement.

PRUDENTIAL REGULATION OF GENERAL INSURANCE

The Inquiry's Terms of Reference recognise the need to balance competition, innovation, efficiency, stability and consumer protection.

In relation to stability and consumer protection, the prudential regulatory regime has ensured APRA authorised general insurers have been in a position to honour their promises and meet their obligations to their policyholders, even at times of major stress and challenge.

This outcome would tend to suggest that the prudential regulatory approach, and the prudential standards that are determined and applied by APRA, are at an appropriate level. NIBA believes there is no evidence of any necessity for stronger prudential regulation of general insurance, especially given the cost to policyholders that higher levels of capital adequacy would incur.

MARKET AND CONDUCT REGULATION OF GENERAL INSURANCE

It is useful to note the historical development of the regulation of market conduct for general insurance products and advice in Australia.

Prior to the Australian Law Reform Commission work in the early 1980's insurance was essentially governed by the law of contract, and the common law that had developed over 200 years in England and Australia in relation to insurance contracts and the distribution of insurance products.

Following the ALRC reports, two major pieces of insurance law were introduced:

- *Insurance Contracts Act 1984*, which continues today with amendments having been made from time to time; and
- *Insurance (Agents and Brokers) Act 1984*.

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[7] APRA *Quarterly General Insurance Performance Statistics*, December 2013, issued 27 February 2014, page 23, available at www.apra.gov.au

The Agents and Brokers Act introduced a number of statutory provisions specifically designed by the Australian Law Reform Commission to provide for and regulate the effective operation of insurance intermediaries in Australia, having regard to the nature of the produces and services they offer to their clients, and the industry in which they operate.

Following the *Financial Services Reform Act 2001*, insurance intermediaries became subject to and regulated under Chapter 7 of the *Corporations Act 2001*. Chapter 7 purports to regulate all financial advice, and makes a distinction between general advice and personal advice. The overall approach of the legislation has been to apply an overarching set of requirements across the financial services sector, a “one size fits all” approach.

The history of legislative amendments since the Financial Services Reform Act has been one of carve outs, exclusions, clarifications, exemptions, as it has been found time and again that the financial services sector, and in particular the specialised risk insurance sector, simply does not lend itself to a “one size fits all” regulatory regime.

STATUTORY AND MANDATORY INSURANCES

The Commonwealth Constitution gives the Australian Parliament power to make laws with respect to "insurance, other than State insurance; also State insurance extending beyond the limits of the State concerned"[8].

While the Australian Parliament has broad powers with respect to insurance[9], the exemption in relation to State insurance has permitted substantial additional legislative enactments by the State and Territory Parliaments. These include the following.

Workers Compensation

The provision of benefits for workplace injury and disease, and arrangements for the insurance of employer liabilities in this area, are governed by State and Territory legislation, with additional legislation by the Australian Parliament in certain areas.

This has led to a seriously fragmented approach to this area of activity:

- Six State workers compensation schemes
- Two Territory workers compensation schemes
- Comcare scheme for Federal public servants
- Comcare scheme for certain private sector companies
- Specialist workers compensation scheme for coal mines in New South Wales
- Specialist workers compensation scheme for seafarers
- Etc.

[8] *Commonwealth of Australia Constitution Act*, section 51 (xiv)

[9] The Parliament has exercised those powers to enact the Insurance Act, the Insurance Contracts Act, and regulatory provisions exercised by APRA and ASIC.

Employers with staff in more than one State or Territory must provide coverage for those members of staff in the State or Territory in which the staff work. The problem is insurance arrangements vary markedly across the various schemes, compensation and benefits vary widely, premiums and premium setting structures vary widely, and differing approaches are taken in relation to key areas such as who is an employee, what constitutes a compensable injury, what type of benefits will be offered, whether common law damages will be available or not, and so on.

There have been calls for national consistency in workers compensation, and many commitments have been given over time to work to achieve national consistency, but the reality today is that little has changed in the past 20 years.

This is an issue that affects a very large number of employers and employees across Australia, and NIBA believes it is now time to achieve a far more efficient and effective workers compensation insurance process in Australia.

It should also be noted that despite major reforms as a result of the National Competition Policy agenda of the early 2000's, there has been no change in the nature and extent of public sector underwriting of workers compensation in Australia. Public sector schemes have had poor financial performance in recent years, with heavy exposure of insurance funds to high risk investments. NIBA firmly believes:

- all employers should have freedom to choose their preferred workers compensation insurer;
- the manager of the risk should "own" the risk, through the transfer of liabilities under the normal insurance process (public sector workers compensation insurers all assert that the financial liabilities are owned by employers, not by the WorkCover "insurer");
- more effective and transparent pricing of workers compensation risk should be introduced.

All of this should occur on a nationally consistent basis, so that employers with staff in more than one State can operate on a more efficient and effective basis, under one set of laws.

Strata Title

Strata title (and equivalent) legislation is the responsibility of State and Territory Parliaments.

Normally, the legislation requires the corporate entity that holds the title to the land and owns the building and the common property to maintain insurance in respect of the property. The terms of the legislation differs as between the States and Territories, and many are in need of update regarding the mandatory coverage specified in the legislation.

The risks and exposures faced by strata title body corporates are essentially the same across Australia, and this is an area where greater national consistency in insurance requirements will be likely to deliver benefits to property owners across the country.

BUILDERS WARRANTY

State and Territory legislation governs the area of "builders warranty" or "home owners warranty" across Australia. The legislation is designed to provide home owners with some degree of protection against defective building work, or cases where the builder goes into liquidation or disappears before the building has been completed. The legislation requires builders (and, on occasion, owner builders) to take out builders warranty insurance to provide some degree of protection to home owners.

The nature and content of builders warranty regulation varies across Australia. The degree of protection varies from State to State, and Territory to Territory.

The nature of the "insurance" is also challenging. While it is called builders warranty, and purports to provide a warranty to home owners, in reality the risk being insured is the financial standing and viability of the builder. The financial viability of the builder is being insured, not the work they perform.

While the intent was to require builders warranty from the insurance markets, insurance companies have largely withdrawn from this area of activity, and the "insurance" cover is now mostly offered by State and Territory government agencies.

If State and Territory governments wish to continue with some form of insurance process, it will be important to carefully determine the nature of the risk (defective work, financial viability of the builder, or some other type of risk), and work with the insurance industry to develop policies that are likely to be able to cover and respond to those risks, and be affordable for home owners.

CIVIL LIABILITY

Public liability insurance policies operate essentially under Federal legislation, primarily the *Insurance Contracts Act 1984.*

However, the public liability insurance crisis of 2002 (where, following the failure of HIH, public liability insurance became difficult to obtain or was only available at prices that were regarded as unacceptable) showed that the risk being insured – compensation and damages awarded as a result of personal injury sustained by third parties – was subject to the laws of various States and Territories.

The Federal Government has the capacity to monitor and assess developments in the insurance markets via Treasury (on matters of industry policy and legislation) and from a regulatory perspective, via APRA and ASIC.

The States and Territory Governments have agencies that work in specific areas – workers compensation, motor accident personal injury compensation, builders' warranty, etc. – but they often have little understanding of the broader working of the insurance markets in Australia. This was clear during the public liability crisis, where there was no clear Ministerial responsibility for public liability issues and challenges at State level.

The issues and challenges arising out of the public liability insurance crisis were addressed via an ad hoc Ministerial group largely comprised of Federal and State Treasury ministers. The Ministerial Meeting on Insurance Issues led to substantial reform of public liability and proportionate liability laws across Australia.

However, as these law reforms were essentially undertaken at State and Territory level, the approach in each jurisdiction often differed from the recommended approach. This is especially the case in the area of proportionate liability (the sharing of responsibility for loss when there is more than one responsible party).

The insurance process in Australia, insurers and policyholders will all benefit from a greater degree of consistency in approach on matters such as this.

INSURANCE REGULATION AND SELF REGULATION

The insurance industry in Australia operates under a "twin peaks" regulatory model, with prudential regulation of insurance companies being undertaken by the Australian Prudential Regulation Authority (APRA) and market conduct being regulation by the Australian Securities and Investments Commission (ASIC). There is also a limited degree of regulatory activity by the Australian Competition and Consumer Commission (ACCC).

Prudential Regulation

As noted above, the general insurance industry witnessed the collapse of one of the largest insurance companies in the country (HIH Insurance group, 2001), but since that time has operated under a more stringent prudential regulatory model with a very heavy emphasis on careful insurance company management of the risks being underwritten, the pricing of those risks, and the maintenance of conservative reserves and reinsurance programs to ensure claims are paid as and when they fall due for payment.

The net result of the post-HIH reforms was the very limited impact on Australian authorised general insurance companies during the global financial crisis, leaving them in a position where they were able to meet their obligations to policyholders following the very considerable natural disasters in 2010, 2011 and 2012.

This outcome would tend to suggest that the prudential regulatory approach, and the prudential standards that are determined and applied by APRA, are at an appropriate level. We note that APRA authorised general insurers maintained 1.88 times the prescribed capital amount of coverage as at 31 December 2013[10]. NIBA believes there is no evidence of any necessity for stronger prudential regulation of general insurance in Australia.

NIBA's concern in this area arises from the role of NIBA Members as advisers to their clients in procuring appropriate insurance protection. Prudential capital requirements come at a cost – shareholders expect and demand compensation for the shareholders' capital that is provided to the business to support prudential reserves. It is inevitable that higher levels of capital adequacy would be likely to have an impact on the cost of insurance products, but this cost will be an added burden

[10] APRA *Quarterly General Insurance Performance Statistics*, December 2013, issued 27 February 2014, page 7, available at www.apra.gov.au

to clients who already have the benefit of an industry that has shown its capacity to meet very significant real world challenges in recent years.

Market Conduct Regulation

Following major financial services reforms in 2001, Australia has now experienced over 10 years of detailed licensing and regulatory oversight by ASIC of financial services providers in Australia.

The Financial System Inquiry provides an opportunity for an independent assessment of the effectiveness of the operation of this regime.

In many cases, improvements have occurred, with minimum education, training and business standards for holders of Australian financial service licences.

In some areas, there are doubts as to the effectiveness of the regulatory requirements. For example, at the ASIC Annual Forum in Sydney on 24 and 25 March 2014, there was much discussion and acknowledgement to the effect that product disclosure obligations do not work, do not result in better informed consumers and do not lead to better decision making by those consumers. They are and can only be a limited part of the end solution.

The key assumption regarding market regulation has been that if consumers are provided with good information, they will act rationally and purchase products and services that are in their interests and meet their needs. Statements by leading Australian and international regulators at the ASIC Annual Forum indicated an acceptance that this assumption is no longer correct.

There are two further key considerations that indicate it may be timely for a careful review of regulatory policy in Australia

It is generally accepted that regulatory policy in Australia is intended to be principles based, which allows a range of responses by market participants as to how they implement and observe regulatory requirements. In reality, with the publication of a large number of ASIC Regulatory Guides and the significant risk of penalty or ASIC action for what ASIC believes may be non-compliance, it would appear that legal and compliance professionals concentrate on complying with detailed matters contained in the Regulatory Guides rather than observing the broad principles in a manner that suits their own business operations.

Secondly, there has been a tendency for regulatory policy to be developed and applied on a "one size fits all" approach. This has resulted in the need for various sectors across the financial services industry to be constantly arguing for adjustments, amendments, carve outs and exemptions from specific regulatory requirements.

The recent and current debates regarding the Future of Financial Advice (FOFA) reforms are an excellent example of this issue. The FOFA reforms were developed following a Parliamentary Joint Committee which examined the collapse of Trio and Storm, and the subsequent losses sustained by many Australian investors. The Committee made a number of regulations designed to improve the nature and quality of financial planning and investment advice in Australia.

The problem with the implementation of those recommendations is that they were effectively applied to all types of financial advice, for all types of financial products. Insurance brokers, mortgage brokers, stock brokers, bank tellers, were all caught by reforms intended to apply to financial planners and investment advisers.

The Parliamentary Joint Committee made no recommendations in relation to advice provided by insurance brokers. Despite this, recommendations designed for products and advice in the area of long term wealth creation and retirement savings were applied to short term general insurance and life insurance risk products.

The following are some examples of issues and concerns that have arisen because of the adoption of this regulatory approach in Australia.

- Group Purchasing Bodies (GPBs): these are arrangements where an entity (the contracting insured) takes out an insurance policy that is specified to provide benefits to its employees, members, or customers. For example, a sporting body may take out personal accident or liability insurance protecting its members as part of the membership fee, or a bank may provide travel insurance as part of a package of benefits for those who use the bank's credit card products. These are insurance arrangements implemented by the GPB in favour of the specified beneficiaries under the policy – those able to claim under the insurance cover. There are significant benefits for those involved in such transactions, given their group nature. By reason of the one size fits all approach, ASIC has taken the view that such arrangements may result in custodial services being provided, and in some cases the provision of a managed investment scheme. Whilst ASIC sought to provide a limited form of Class Order relief, it is unnecessarily limited and complex. NIBA has been making submissions to the Federal Government and to ASIC in relation to this matter since 2008, and as a result ASIC has effectively postponed certain aspects of the Class Order relief since that time. In reality, all agree a better solution is needed, but unfortunately it takes a significant amount of time having regard to things such as change of Governments and regulator staff turnover.

- Definition of Retail Client: it is accepted that less sophisticated clients require greater protections than clients versed in making financial decisions. The current definition of "retail" in the general insurance context is based on whether the insured is an individual or small business employing a certain number of employees AND whether the product is of a listed type of product, without regard to other relevant factors. There are some real concerns with the scope of the product definitions used, which could be seen as going beyond what was originally intended and discussed. As a result there is a degree of inconsistency in market practice depending on what view is taken. Other financial products are subject to four key tests: product value, individual wealth, professional investors and small businesses. NIBA believes it is timely to review the definitions of "retail" and "wholesale" client, to ensure all key circumstances are taken into account, and to allow a client to be treated as a sophisticated purchaser along the lines of the "sophisticated investor" definition of Chapter 6D of the Corporations Act.

- Disclosure documentation for retail clients: as noted above, it is now becoming widely accepted that current product disclosure requirements are not working, the materials are not read, and the disclosure does not lead to more informed and better decision making by consumers. NIBA believes critical review of disclosure obligations is now warranted.

- Information or advice: currently there is much debate about the nature and content of general advice and personal advice (including what is called scaled personal advice). Under current regulatory requirements, personal advice carries the highest level of regulatory obligations, and general advice the least. A consumer with only limited knowledge and understanding of financial products is unlikely to be able to understand the subtle differences between general advice and personal advice. When they ask about a product, they may assume they are receiving personal advice, even though they may only be getting general recommendations and information about the product. Whilst a general advice warning is required by anyone providing general advice it currently may not be fsufficient to warn customers of the nature of the advice being received. NIBA believes there must be greater clarity between general advice and personal advice, in order to ensure consumers understand whether they are receiving general recommendations or personal advice on whether a product is appropriate for their personal needs or not.

- Scaled advice: with the provision of scaled advice, the crucial issue is to ensure the customer understands how the advice is "scaled" and the relevance and impact of this scaling, and that the advice provided is appropriate. This would be of real importance where such a service is provided by a product issuer or their agent, given the inherent conflicts of interest that can arise in these circumstances.

- Who do you act for: NIBA also believes it is critical that anyone giving information or advice in relation to financial products and services should make it very clear at the outset whether they are acting on behalf of their employer or appointor (in cases where they are an authorised representative or an agent of a product manufacturer) or whether they are acting on behalf of the client. This should not be hidden in documentation as it is a significant warning to the client that any general recommendations given are in reality on behalf of the product issuer and not the client.

The appendix to this Submission contains an outline of the ways in which the financial services regulatory regime contained in Chapter 7 of the Corporations Act affects insurance brokers.

One of ASIC's key objectives is to "contribute to Australia's economic reputation and wellbeing by ensuring that Australia's financial markets are fair and transparent, and supported by confident and informed investors and consumers"[11]. In the area of insurance products and services, the overall

[11] See: http://www.asic.gov.au/asic/ASIC.NSF/byHeadline/Our%20role#protecting

approach has been one of promoting improved financial literacy followed by extensive market regulation.

NIBA respectfully submits that no amount of financial literacy and education programs will produce "confident and informed consumers" of risk insurance products – the community does not understand and appreciate the nature and extent of risk, and the community will never become familiar with the nature and extent of insurance products and policies that are available in the market.

In these circumstances, NIBA respectfully submits that the only realistic way to achieve confident and informed consumers of insurance risk products is to promote financial literacy followed by the need to seek qualified, professional advice from a licensed adviser who is experienced and expert in risk and insurance matters In other words, an insurance broker.

Who does what?

While the distinction between prudential and market conduct regulation is reasonably clear, it may be timely for a careful re-assessment and confirmation of the relative roles and responsibilities of APRA and ASIC, to ensure they are both focussed on clear and unambiguous areas of responsibility.

It may also be timely for a careful review of the scope of coverage of regulatory activity in Australia. This issue became important when the Banksia organisation failed, and many individuals and businesses in rural Victoria lost substantial amounts. Banksia was not a deposit taking institution, and was not, therefore, subject to prudential regulation by APRA. But the company was acting with all the hallmarks of a deposit taker, with "investments" (in reality deposits) being at call and subject to withdrawal at any time.

Similar issues can arise in relation to discretionary risk management type arrangements. These arrangements have the appearance of insurance companies – they can receive contributions, and assess and pay claims.   However they are not insurance companies, as it is left to the discretion of the issuer as to whether a claim will be paid or not. With an insurance policy, if the claim fits within the terms of the insurance contract the insurer is legally bound to pay the claim. NIBA is aware of at least one arrangement of this nature offering its services to the general public, where it is questionable as to whether the public would be unlikely to understand the discretionary nature of the arrangement and other pertinent facts. Once again, because this is not insurance, there is no prudential regulatory oversight of such bodies.

Self Regulation

Insurance brokers and the National Insurance Brokers Association have for many years sought to promote the need for quality, professional, qualified advice and support for their clients. Self regulation of insurance broking has taken three forms:

- NIBA College is an accredited Registered Training Organisation, providing Certificate, Diploma, Advanced Diploma and Graduate Diploma level training and qualifications for those wishing to work in insurance broking in Australia. NIBA strongly recommends the Diploma in Insurance Broking as the required qualification for insurance broking. This level of qualification is more extensive than that currently required by ASIC.

- Qualified Practising Insurance Broker – QPIB – status has been established by NIBA for many years as an objective indicator to clients and the community that the insurance broker is qualified and experienced to provide high quality, expert advice on risk and insurance matters.

- The Insurance Brokers Code of Practice has been thoroughly reviewed and revised to ensure the industry's offering to clients and the community remains up to date and relevant. The revised Code of Practice will take effect and be binding on all NIBA Members as from 1 July 2014. The Insurance Brokers Code of Practice is available at: https://www.niba.com.au/codeofpractice/index.cfm

INSURANCE TAXES

Virtually all general insurance policies in Australia are subject to two taxes: GST, and State or Territory stamp duty. In New South Wales, and for certain policies in Tasmania, fire services levies are a third revenue burden carried by policyholders.

The combined operation of GST and stamp duty tends to increase the cost of general insurance by around 18 – 20%, depending on the jurisdiction.

In 2013, the Queensland Government increased the rate of stamp duty on general insurance policies. Queensland property owners had faced very substantial increases in property insurance premiums following the cyclones and floods of 2010, 2011 and 2012. Increases for strata body corporate insurance were in the range of 800%. Property insurance in Queensland currently carries insurance taxes of 19%, adding considerably to the burden carried by the community in that State.

The ACT Government is currently implementing a program of gradual removal of stamp duty on insurance policies. This has been welcomed and applauded by the insurance industry, and by insurance brokers.

New South Wales is now the only mainland State or Territory to maintain a fire (emergency) services levy on insurance premiums. Victoria removed fire services levies on insurance policies taken out or renewed after 1 July 2013.

Insurers and insurance brokers have been calling for the reform of insurance taxes for many years. The argument is simple: insurance helps people and businesses recover from loss, when an unfortunate (insured) event occurs. Insurance helps people and businesses restore their financial position, and to continue their private life or their business operations.

Independent reviews of insurance and insurance taxes, from the relatively recent Henry tax review back to the HIH Royal Commission, have all called for the reform of insurance taxes in Australia.

In the case of fire services levies, the approach has been to replace a levy on insurance premiums (which results in fire services operations being funded by those who take out insurance) to a levy on property (which results in fire services operations being funded by all who benefit from the operation of the fire and emergency services). As noted above, New South Wales is the only mainland State yet to reform these levies.

It is acknowledged the reform of State and Territory stamp duty on insurance policies is likely to be more difficult. Stamp duty on insurance premiums provides substantial revenue flows to the State and Territory Governments. It is natural that State and Territory Governments would want or indeed need to find alternative forms of revenue to replace stamp duty on insurance.

NIBA calls once again for the Federal Government to provide the leadership in the reform of insurance taxes, and the development of alternative taxation arrangements whereby State and

Territory Governments can meet their revenue needs without adding an undue burden to those to protect their personal and business assets and income by taking out insurance. This may well mean reform of the operation and rate of GST.

General government expenditure should be funded by broad based taxation revenue, not by taxes and levies on specific products or services which operate in the community's interest.

NIBA calls on the Financial System Inquiry to add its voice in support of the need for reform of insurance taxes in Australia.

THE FUTURE

The OECD, the Council of Australian Governments, the Productivity Commission and many others have identified, confirmed and agreed on the core principles that must be applied whenever consideration is being given to regulatory intervention in markets and the economy. They include:

- a clear statement of what actually is the issue being addressed
- is there a sound legal and empirical basis for this issue
- have all potential options for dealing with the issue been identified and assessed, including the option of no further action
- a clear statement of the proposed regulatory intervention, including the governing principles that will be used to guide the development of the regulatory intervention
- a sound legal and empirical basis for the proposed intervention, including a clear assessment of the nature and value of benefits to be derived, and the nature and level of costs (including compliance costs) that will be incurred as a result of the intervention
- a careful analysis and assessment that the proposed intervention will produce benefits that justify the costs, considering the distribution of effects across society, and taking into account economic, environmental and social impacts of the intervention
- assurance that the proposed intervention will minimise costs and market distortions
- strategies to ensure the regulation will promote innovation through market incentives and promote global approaches to strong and effective community outcomes
- be clear, simple and capable of practical adoption
- be consistent with other regulations and policies
- be compatible as far as possible with competition, trade and investment-facilitating principles at domestic and international levels.

The history of financial services regulation in Australia does not show strong and consistent observance of these key principles. A preference for principles based regulation has been followed by hundreds of pages of statutes, regulations, regulatory guides and other instruments. The "one size fits all" approach has resulted in regulations designed for one sector being applied inappropriately in other areas, where there were no issues or concerns in the first place.

NIBA urges the Financial System Inquiry to strongly recommend the application and observance of these key principles in any further regulatory reform of the Australian financial services system.

NIBA also strongly commends the Australian Government on its focus of reducing red tape. This has already had a significant and positive impact in NIBA's dealings with the Government and with regulators.

FURTHER INFORMATION AND CONTACT DETAILS

For further information or clarification of any matter in this Submission, please do not hesitate to contact:

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APPENDIX

The appendix to this Submission contains an outline of the ways in which the financial services regulatory regime contained in Chapter 7 of the Corporations Act affects insurance brokers.

NIBA OVERVIEW OF THE FINANCIAL SERVICES REQUIREMENTS IN CHAPTER 7 OF THE CORPORATIONS ACT AND AREAS OF POTENTIAL CHANGE

Set out below is a summary of the key FSR obligations affecting insurance brokers and areas identified where change should be considered.

FINANCIAL SERVICES GENERALLY

In relation to insurance, any person provides a financial service where they:

- provide financial product advice, or
- provide a dealing service (for example, issuing or arranging a general insurance product),

in relation to an insurance product caught by the Act.

Scope of insurance caught by the Act

The Act applies to most insurance products, with the notable exceptions being reinsurance and State insurance.

Currently there does not appear to be any issue with what insurance the Act does and does not catch.

In relation to non-insurance risk management products, there seems to be a degree of uncertainty regarding the relevant product type/services applicable to a discretionary mutual fund.

There is no current guidance from ASIC on what is and is not "insurance" which many regulators contain in guidance given its significance. There is guidance in relation to extended warranties which is useful. Consideration should be given to such guidance. This could be done in conjunction with APRA which also does not have any such guidance.

Insurance claims handling and settlement services are not financial services

There is no concern with this carve out.

Financial product advice

There are two types of financial product advice: "personal advice" and "general advice" which are defined in s766B as follows:

General advice	Personal advice
A recommendation or a statement of opinion, or a report of either of those things that: • is intended to influence the person it is given to in deciding something in relation to a financial product (or class of one or interest in one); or • could reasonably be regarded as being intended to have such an influence.	The person in making the recommendation or giving the opinion has considered one or more of the person's objectives, financial situations or needs or would reasonably be expected to have done so by the person they provide it to. The concept of "scaled advice" has been introduced by the recent FOFA amendments which is personal advice within agreed parameters.

NIBA believes persons giving general advice should more clearly point out the limitations of such advice. The General Advice Warning requirement is not in NIBA's view sufficient to give sufficient warning.

Scaling of advice - NIBA supports the currently proposed best interest duty changes whilst noting they remain by their nature somewhat unclear. In relation to the ability to agree on the scope of advice, NIBA notes any attempts by product issuers or related product distributors to provide scaled personal advice should be monitored given the special conflicts of interest that may arise in such cases.

Factual information

The provision of pure factual information will not be viewed as financial product advice.

Factual information is objectively ascertainable information the truth or accuracy of which cannot be reasonably questioned. It must not involve the expression of any express or implied opinion or recommendation. If it does, it would constitute financial product advice.

A common issue that arises is in relation to branded products and whether the use of a brand of a partner is advice or not.

Different views are taken in the market and NIBA believes clarity should be provided as in its view the use of an entity's brand should at least be seen as the provision of general advice unless there are significant and prominent disclaimers.

Dealing

As it applies to general insurance, dealing is defined as follows:

- applying for or acquiring a financial product;
- issuing a financial product;
- varying a financial product;
- disposing of a financial product; and
- arranging for a person to apply for or acquire, or to issue, vary or dispose of a financial product**.**

The main issue is usually the grey area on whether a person is "arranging" or acting as a clerk & cashier/referrer non-financial service provider. ASIc has provided Guidance but greater clarity is probably required to reduce inconsistency in the marketplace as different positions can be taken depending on the view taken.

Who are retail and wholesale clients?

Subsection 761G(5) of the Act sets out when a person will be seen as a retail client in relation to general insurance products.

There are two tests which **BOTH** must be met for a person to be seen as a retail client. If one is not met the client is wholesale.

The product must:

- be provided to an individual; or
- be or would be, for use in connection with a small business (i.e. a business employing less than – if the business is or includes the manufacture of goods – 100 people; or otherwise – 20 people)**.**

If the "insured" under the policy is not within the above categories then they will not be retail clients.

There is an exemption which provides that where a financial product or service is provided to or acquired by a body corporate as a wholesale client, related bodies corporate of the client are also taken to be wholesale clients in respect of the provision or acquisition of that product or service.

A person in the above category will not be a retail client if they are not provided with a policy which provides cover of the type specified in regulations 7.1.11 to 7.1.17A. They will only be a retail client for the cover that is caught and not any cover that isn't (this is the case even if it is a bundled product).

The legislation will consider that any part of a contract of insurance which provides cover of the type defined, will be treated as caught by the retail client definition. The other parts of the cover not related to the cover which is caught, will not however be treated as retail. This means that packaged products may be part retail and part wholesale depending on whether any cover section includes the retail client type cover.

For example, if a policy (whether stand alone (e.g Liability policy) or a section of a package cover) covers a "motor vehicle" as defined in the regulation for loss or damage or liability for loss of, or damage to, property caused by or resulting from impact of a motor vehicle with some other thing, then the cover in relation to that motor vehicle is arguably caught provided the relevant insured is an individual or small business as defined above in the who test.

This would not have been the intent of the original legislation and NIBA believes that this incidental coverage issue could be tidied up for better clarity.

ASIC also seems to take the view that a policy provided to an insured where third parties are automatically covered as interested third parties (i.e. parties that are not contracting parties such as section 48 parties under the Insurance Contracts Act 1984 (Cth)) will be seen as being provided to the contracting insured and not the third parties for the purpose of this test. This is a sensible view but could be better clarified.

For life risk products and other risk management products the definition is different and based on a number of other tests.

Consideration as to whether such tests make sense in the general insurance context could be considered along with whether the small business test is still appropriate.

LICENSING

Generally

A person can ONLY provide a financial service:

- under its own AFSL,
- as an employee of an AFSL holder,
- as an authorised representative (AR) of an AFSL holder,
- as a Distributor of an AFSL holder under ASIC Class Order 05/1070,
- if subject to another licensing exception (e.g an Insurer provides a financial service to wholesale clients without needing an AFSL authority for this by way of an exception).

Some people can assist in the distribution process without providing a financial service. They are usually called:

- mere referrers, and
- clerks & cashiers.

Industry would benefit from clearer guidance on the above two concepts.

Wholesale client business obligations

Currently insurers which are APRA regulated do not need an AFSL authorisation for wholesale client business. Insurance brokers need an AFSL for retail and wholesale client business.

For wholesale client business insurance brokers have to comply with:

- general licensing conditions:
    - do all things necessary to ensure that the financial services covered by the licence are provided efficiently, honestly and fairly; and
    - have in place adequate arrangements for the management of conflicts of interest that may arise wholly, or partially, in relation to activities undertaken by the licensee or a representative of the licensee in the provision of financial services as part of the financial services business of the licensee or the representative; and
    - comply with the conditions on the licence; and
    - comply with the financial services laws; and
    - take reasonable steps to ensure that its representatives comply with the financial services laws; and
    - have available adequate resources (including financial, technological and human resources) to provide the financial services covered by the licence and to carry out supervisory arrangements; and

    - maintain the competence to provide those financial services; and
    - ensure that its representatives are adequately trained, and are competent, to provide those financial services; and
    - have adequate risk management systems.
- the general consumer protection provisions relating to misleading and deceptive conduct. No specific disclosure obligations apply like those that do in relation to retail clients.

Generally there are no issues regarding the above.

Authorised representative acting for insurance broker

S916D prohibits a licensee acting as an AR of another licensee unless under binder (s916E). The provision does not reflect the intent of the legislation and ASIC has since provided specific relief on an application basis. The basis for this relief could be incorporated in the legislation.

The recent *Full Federal Court decision of ACE V TRIFUNOVSKI* has significant implications for the financial services industry The case involved authorised representatives of an insurance company who were engaged as independent contractors, but were found by the Court to be employees. A key reason for the decision was the extent of the control which the insurer was found to have exerted over the authorised representatives.

Given the requirements to monitor, train and oversee authorised representatives set out in the Corporations Act and arising as part of the implementation of the FOFA reforms, the effect of the decision makes it practically impossible to structure and achieve individual independent contractor relationships as opposed to employee relationships within the regulated financial services industry.

This is contrary to the intended outcomes of the legislature in imposing control requirements for authorised representatives – namely to ensure standards of competency and accountability in the sector, ultimately for the purposes of promoting consumer protection; not to mandate the legal character of principal and agent relationships. The decision creates significant uncertainty over the characterisation of past, existing and future independent contractor arrangements. It could have significant adverse financial consequences where as a result of the decision, independent contractor relationships are re-characterised as employee relationships. Regulatory clarity of the issue is preferred where possible.

Service company issue e.g a Licensee uses a service company that employs its representatives. The law technically could require the service company to have an AFSL but this was probably not the intent if it plays no role in the provision of financial services other than by providing use of its employees to the entity providing financial services. Whilst ASIC has sought to clarify the matter this could be improved on to help avoid limit uncertainty and inconsistent market practices.

General Insurance Distributor CO 05/1070 acting for insurance broker

No issues. Example of one size fits all post implementation fix.

Licensee acting for insurance broker under own AFSL

No issues other than some uncertainty regarding Act’s imposition of liability for “representatives” in such circumstances which could be better clarified..

General Licensing Obligations

An insurance broker must meet certain general licensing conditions.

No issues with general conditions.

Training

RG 146 sets out ASIC's position regarding training. There are new ASIC training proposals that are of real concern to NIBA and this is a significant area that needs to be considered carefully and not be made subject to a one size fits all model.

Obligation on an insurance broker to notify significant breaches

If an insurance broker forms the view that there is a significant breach it must report this to ASIC within 10 business days after becoming aware of the breach or likely breach. Non-significant breaches must be recorded in the breach register. ASIC has provided guidance on what is significant but ultimately it is a subjective call.

No issues with this or ASIC's approach to date.

Liability for representatives

The Act imposes strict liability on licensees for the acts of their representatives whether within or outside their scope of authority subject to certain carve outs.

The rules that apply (e.g regarding class of insurance distinction) can create an unfair end result in certain cases that should be fixed.

RETAIL CLIENT PROTECTIONS

There are special rules that apply in relation to customers who are “retail clients” as explained earlier.

Financial Services Guide (FSG) requirements

Financial services licensees and authorised representatives who provide financial services to retail clients are required to give those retail clients a Financial Services Guide (FSG) unless an exception applies.

The purpose of the FSG is to ensure that retail clients receive key information about the type of services being offered by a licensee or an authorised representative (AR).

In reality it is questionable whether the FSG serves any useful purpose given in most cases it principally tells a customer:

- the broker can provide a service for them or for the insurer;
- the broker may provide factual information, general advice, personal advice or a combination of all three;
- may be remunerated in a number of ways;
- is subject to compensation requirements and an IDR/EDR scheme.

On receiving it the customer is aware of what MAY occur but not what WILL occur.

This is because the FSG must be given to the client as soon as practicable *after it becomes apparent to the providing entity that the financial service will be, or is likely to be*, provided to the client, and must in any event be given to the client before the financial service is provided. This test is not as clear as it could be. See later for delivery issues.

Ultimately the customer is told by the broker what applies to them in other documentation.

The FSG doesn’t add any real protection that the old obligations in the IABA to give written notice of certain things before or at the time the contract was entered into didn’t. The FSG achieves consistency of form of delivery of basic information but probably little else and may affect innovation.

Consideration should be given to an alternative model where a standard form of disclosure/education tool for customers could be referred to saving brokers money and leaving them to disclose the actual arrangement in their other documents as part of the normal distribution process.

A person does not have to provide an FSG in certain circumstances.

The time critical exception should be considered as it could be made more practicable.

it does not seem fair for insurers to have an FSG exception if only issuing a product when insurance brokers have to give one if they are only providing an issuing only service for an insurer. All issue only/arranging agents should not have to give an FSG as it adds limited value. Key information could instead be provided in another form that makes it clear for example that the agent does not act of the customer, acts for the insurer, only provides general advice and is remuneration for a successful sale.

The secondary service provider FSG carve out should be better clarified in the legislation to avoid confusion.

General Advice Warning requirements

A providing entity (which is either a licensee or an AR) who is providing general advice must warn the retail client that:

- the advice has been prepared without taking account of the client's objectives, financial situation or needs; and
- because of that, the client should, before acting on the advice, consider the appropriateness of the advice, having regard to the client's objectives, financial situation and needs; and
- if the advice relates to the acquisition, or possible acquisition, of a particular financial product—the client should obtain a Product Disclosure Statement relating to the product and consider the Statement before making any decision about whether to acquire the product.

Generally, warnings must accompany all general advice regardless of the medium used to provide that advice but should be given by the same means as the general advice is given.

In ASIC's view, providing entities will meet this obligation where they convey the substance of s949A(2) in a way that is likely to result in clients understanding the message

ASIC acknowledges that it is good practice for providing entities to develop their own wording to make their general advice warnings more meaningful to clients.

There is class order relief from the general advice warning requirement when a person gives oral general advice to retail clients, and provide a simplified oral warning. A warning only needs to be given once in any telephone conversation or face-to-face meeting where general advice is provided to a retail client.

This is probably one of the most significant forms of warning for insurance brokers who won't give personal advice.

Given the importance of understanding the inherent limitations of general advice consideration should be given to whether the GAW properly delivers this key message to consumers.

Statement of Advice/Record of Advice

A licensee or an AR of a licensee providing personal advice to retail clients must give them a Statement of Advice (or Statement of Additional Advice) that meets certain content requirements.

There are 3 main carve outs from the requirements to issue an SOA to a retail client.

- The first is where the advice relates to a general insurance product (except for advice about sickness and accident or consumer credit insurance).
- The second is where the advice does not recommend the acquisition or disposal of any specific financial product
- The third is in the case of further advice.

Where an insurance broker does not give the client an SOA under the second or third exception, they need to keep a record as required under the Act.

Where a SOA exception applies the client must instead, when, or as soon as practicable after, the advice is provided, be given certain specified information that would be required to be in the Statement of Advice ie the remuneration SOA information content and SOA information about any other interests and that might reasonably be expected to be or have been capable of influencing the providing entity in providing the advice.

there are no major concerns with the current SOA requirements although consideration of whether CCI should require a SOA should be reconsidered.

Product Disclosure Statement (PDS) Requirements

An insurer, as the issuer of the insurance product must prepare a PDS for all retail client insurance.

The PDS is the document designed to provide the retail client with certain key information that is designed to help them make a decision about whether to buy the product or not and to compare it with other products.

An Insurer must give a person a PDS if an Insurer offers to issue the insurance product to the person or the insurance product is or is to be issued to the person as a retail client. Insurance brokers will typically provide it to their insured clients and received them from insurers.

Making sure the PDS provided is the most up to date version is a key risk for insurance brokers.

It is well acknowledged consumers do not read the PDS. It has improved insurer drafting practices in certain respects but in reality the duty of utmost good faith and IC Act protections are very high. The main PDS risk for insurers is the clear concise and effective content requirement which is of course subjective.

There are certain PDS exceptions, the most significant being the time critical exception.

It is worth revisiting these exceptions as ASIC has provide relief, especially in relation to quotes because of the limited scope of the exceptions.

In relation to the PDS content (of note):

- A PDS must include information about any significant benefits to which a holder of the product will or may become entitled, the circumstances in which and times at which those benefits will or may be provided, and the way in which those benefits will or may be provided. This is very subjective and has always been an issue.

- The dollar disclosure requirements are overly complex and need to address technical gaps identified. the Clas Order relief has a number of gaps that can be tidied up.

- What does the client have to pay – the content requirements here can be improved as they serve little useful purpose in reality.

- For a general insurance product PDS, you must include:

    - the terms and conditions of the policy document being terms and conditions that are not provided in a Schedule to the policy document [This is extremely unclear as a concept]; and

    - information that, if the issuer is seeking to rely on subsection 35 (2) and s37 of the Insurance Contracts Act, the issuer would have had to provide to the insured before the contract of insurance was entered into.

- Information about the dispute resolution system that covers complaints by holders of the product and about how that system may be accessed**.** The amount of information required is open to debate – ASIC is taking the view that full FOS contact details are required.

- Financial Claims Scheme information – This is completely pointless for a consumer.

- Cooling off period – No significant issues identified.

- Consumer Credit Insurance Products – no concerns with special disclosure requirements. NIBA notes ASIC has and is conducting a review on CCI and other add on products.

- UFI special notice requirements – no concerns with content requirements.

A supplementary PDS containing updated information may be given with a PDS that has become out of date. No issues with SPDS process.

Keeping a PDS up to date – No major issues raised with the obligations in this regard.

Delivery of FSG and PDS

The ways of giving an FSG (or where applicable, the information that needs to be orally given) is the same as for a PDS. It can be given (in printed or electronic form or as oral information):

- to the client, or to the client's agent, personally or orally (as applicable); or
- sent to the client, or the client's agent, at an address (including an electronic address) or fax number nominated by the client or the client's agent; or
- otherwise made available to the client, or the client's agent, as agreed between the client, or the client's agent, and the providing entity. This method of delivery can only be relied where the method the providing entity has chosen is such that it has reasonable grounds to be satisfied that the client has actually received the FSG**.**

If a providing entity relies on the "make available" option, ASIC states that as a matter of good practice, the providing entity should:

- ensure that the client has positively agreed to having the FSG made available by that means; and
- take reasonable steps to ensure that the FSG will in fact be readily available to the client by that means.

An FSG can be made available to the client, or the client's agent, as agreed between the client, or the client's agent, and the providing entity, by making it available on a website that is maintained by or on behalf of the providing entity and giving a notice, in printed or electronic form, to the client, or the client's agent, that it is available on the website.

An FSG in electronic form should as far as practicable be given in a way that will allow the recipient to maintain a copy of them so that they can be accessed in the future. FSG that is given electronically must also be clearly identifiable from other information so that the recipient of the information is not confused, for example, about what information is and is not part of a financial services guide.

Note that the FSG can only be given or sent to the client's agent if the agent is ***not*** acting in one of the following capacities:

- a Licensee;
- an AR of a Licensee;
- a person who is not required to hold an AFSL under the Act or other applicable exemptions;
- a person who is required to hold an AFSL but who does not hold an AFSL;
- an employee, director or other representative of a person referred above.

This can create technical issues where an insurer FSG is provided to the broker licensee acting as agent for the client. This cannot have been the intent.

Confirmation of transactions requirements

The Act requires certain transactions involving retail clients to be confirmed by the product issuer (ie insurer or its agent) as soon as reasonably practicable after the transaction occurs in accordance with the procedure set out in section 1017F. No significant issues identified.

Cooling off period requirements

In summary, the cooling off provisions require an Insurer to give a retail client a right to return their policy in certain circumstances.

Of note is the fact that a right to return a policy for an event that will start and end within the 14 day period (and to have money paid to acquire the policy repaid) cannot be exercised at any time after the end of the period, starting when the policy was provided and ending on the earlier of:

- the 14-day period; and
- the start of the event.

E.g.: Short-term travel insurance.

Event means the commencement of the process in relation to which the risk insurance product was entered into.

E.g:

- For insurance on household goods during removal, the commencement of loading a transportation vehicle is the event.
- For travel insurance, the commencement of the journey is the event.

The above start of the event is not entirely clear and the drafting could be improved.

The retail client is not able to exercise the cooling off right if they have exercised a power or right under the policy (e.g made a claim) or the policy has ended. E.g. if the product is a policy covering a period of only one week, the right to return cannot be exercised after the end of that week.

The cooling off period does not apply to:

- interim policies; and
- any general insurance product that is:
  - of less than 12 months duration; and
  - a renewal of an existing product on the terms and conditions to which the product is currently subject (e.g mobile phone monthly policies).

The right can be exercised in writing or electronically or by telephone or any other way *permitted by an Insurer*.

Insurers should be required to make it as easy as possible. Minimum obligations may be worth considering.

Anti Hawking requirements

Under the Act a person must not offer financial products for the issue or sale:

- in the course of, or
- because of,

an unsolicited meeting or telephone call.

The anti-hawking provisions aim to prevent pressure selling of products to retail clients.

The anti-hawking provisions only apply to unsolicited telephone calls or meetings.

The anti-hawking provisions do not apply to other unsolicited forms of communication such as emails*, letters or other marketing brochures or advertisements.

The main issue arises in telephone sales and the need to give a PDS before the product is bound.

Consideration of how the anti hawking provisions interact with the PDs delivery requirements and exceptions is open to argument and need to be clarified.

Advertising

Section 1018A of the Act provides that if a particular financial product is available for acquisition by persons as retail clients (whether or not it is also available for acquisition by persons as wholesale clients) by way of issue, an Insurer must only:

- advertise the product; or
- publish a statement that is reasonably likely to induce people to acquire the product;

if the advertisement or statement:

- identifies an Insurer;
- indicates that a Product Disclosure Statement for the product is available and where it can be obtained; and
- indicates that a person should consider the Product Disclosure Statement in deciding whether to acquire, or to continue to hold, the product.

If a particular financial product, or proposed financial product, is not available for acquisition by persons as retail clients but it is reasonably likely that the product will become so available (whether or not it is, or will also become, available for acquisition by persons as wholesale clients) by way of an Insurer must only:

- advertise the product; or

- publish a statement that is reasonably likely to induce people to acquire the product;

if the advertisement or statement:

- identifies an Insurer;
- indicates that a Product Disclosure Statement for the product will be made available when the product is released or otherwise becomes available;
- indicates when and where the Product Disclosure Statement is expected to be made available; and
- indicates that a person should consider the Product Disclosure Statement in deciding whether to acquire, or continue to hold, the product.

In addition to section 1018A, depending on the type of advertising and method, the General Advice Warning and FSG content disclosure obligations can arise too.

The carve outs for full disclosure could be reconsidered.

Money handling requirements

Where an insurance broker acts on behalf of the insured special rules apply.

The Corporations Act in Part 7.8:

- requires the insurance broker to put any premium received from the insured into a special trust account,
- where the policy has been entered into/risk has passed receipt of premium from the insured by the insurance broker is treated as receipt by an Insurer,
- If the insurance broker doesn't pay an Insurer, an Insurer must bring a recovery action against the insurance broker for the amount owing. an Insurer cannot cancel the policy or refuse a claim under the policy because of non-payment by the insurance broker in such cases,
- the money must be passed to an Insurer by the insurance broker by the earlier of the:
  - › time agreed between an Insurer and the insurance broker, and
  - › timeframe specified in the Corporations Act (usually 90 days from receipt with a limited exception where not reasonably practicable).

There are monetary penalties that apply if the insurance broker fails to comply.

If an insurance broker has not received the premium within the relevant period for payment required by an Insurer other rules apply.

Claims money paid by an Insurer to an insurance broker is not treated as being received by the insured until the insurance broker pays the insured. This means that if the insurance broker does not pay the money to the insured, an Insurer must bring a recovery action against the insurance broker for the amount owing.

Where the insurance broker receives money from, or on behalf of, an Insurer, for payment to, or on behalf of, an insured, they must pay the money to the insured:

- within seven days (the relevant period) after they received the money, or
- if it is not practicable for them to pay the amount within the relevant period – as soon as practicable after the end of that period.

The money handling requirements, especially relating to mixed money is relatively complicated.

The 90 day and other rules rule follows the old IABA rules as do the deemed receipt rules.

There are some technical issues that can be fixed but nothing of any real concern.