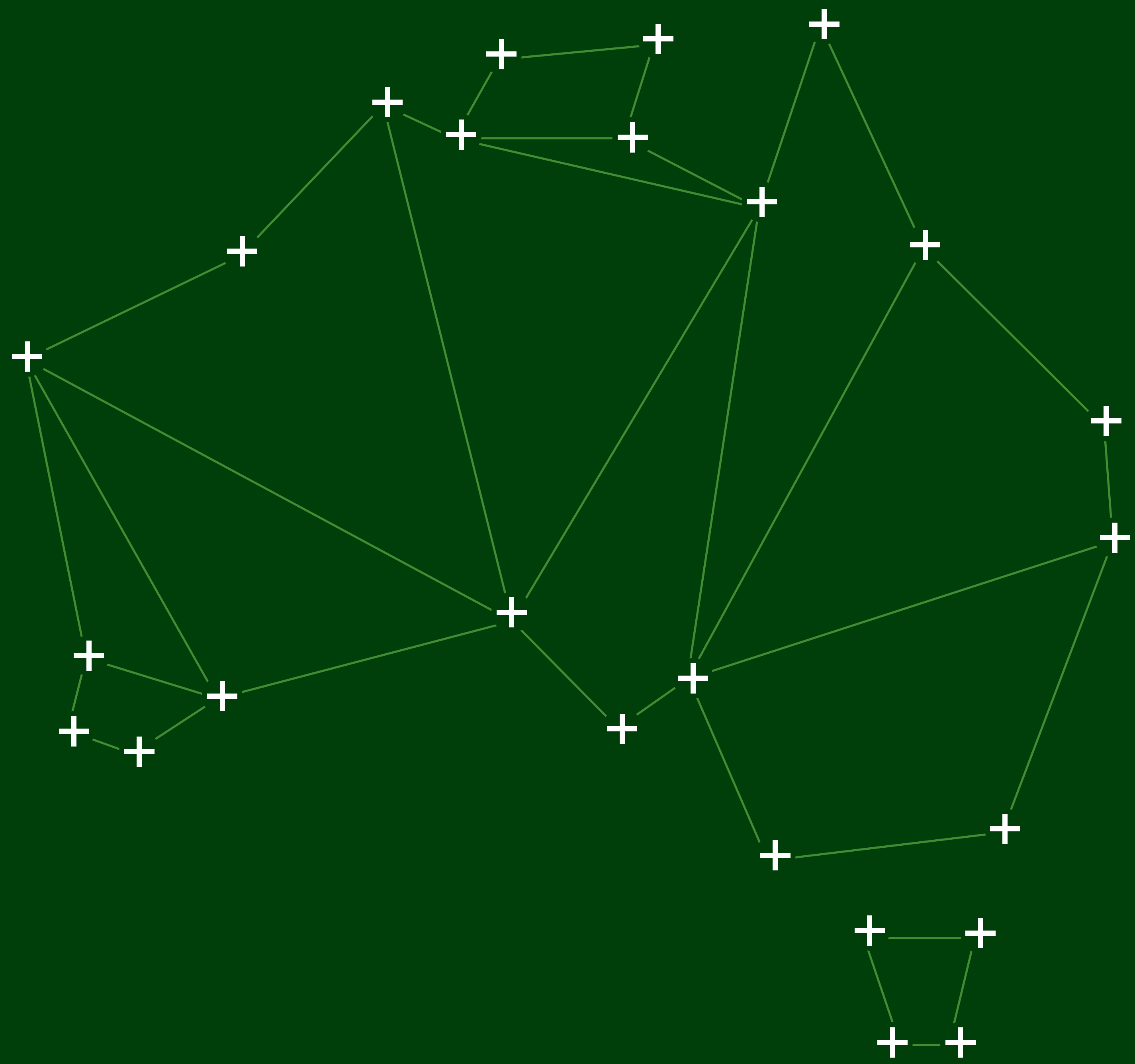

Financial System Inquiry

Submission

TAL

Contents

31 March 2014

Mr David Murray (AO)
Chairman
Financial System Inquiry
GPO Box 89
Sydney NSW 2001

Dear Mr Murray

Financial System Inquiry

I refer to the terms of reference for Financial System Inquiry (FSI) and make this submission on behalf of TAL Dai-ichi Life Australia Pty Limited (TAL) and its subsidiaries. TAL welcomes the establishment of the Inquiry and the opportunity, as Australia's largest life insurer, to contribute to it.

TAL agrees with the FSI statement that 'while the financial sector has served Australia well…it has been transformed by forces such as domestic and international economic and financial crises, a substantial regulatory reform agenda, the growth in superannuation, changes in industry structure, new competitive dynamics, technology, innovation and broader macroeconomic trends'.

Our observation is that this statement holds true for the life insurance sector as well as the financial system more broadly.

The size of the life insurance market reflects the quantum of change. In 1997, at the time of the Wallis Report, Australian life insurance in-force risk premiums were $2 billion. The latest figures, released in December 2013, show that the market has grown to in excess of $12 billion.

With a proud heritage and a tradition of community support and service stretching back 140 years, TAL has observed and contributed to this growth. We believe life insurance makes a positive contribution to Australian society. Today we protect over 2.5 million Australians and hold in-force life risk premiums of $1.87 billion. In 2013 we paid out and reserved for claims in excess of $1.3 billion, up over 45% on 2012.

Our life specialist position provides us with unequalled experience in the life insurance sector and is one we take seriously as we strive to be a leader in the financial services industry and advocate for, and deliver, a sustainable life insurance sector.

Being part of the conversation requires us to be prepared to act – to consider what customers need today and what they may need in 2044. We must also consider how we enrich and protect the lives of those we cover through the delivery of our products and services.

It is our view that life insurance delivers tremendous value through collective superannuation group schemes and should remain a key feature of superannuation funds, with trustees determining the appropriate base or default levels of cover for the fund members.

We also believe the direct market is a valuable way to ensure that a broad range of Australians have access to life insurance. Many Australians prefer to transact directly and this market sector serves them well. Over the last several years, as a champion of a sustainable life insurance industry, TAL has:

- Adopted a multi-distribution channel model to reflect changing consumer behaviours so that we can provide financial protection to customers in ways of their choosing, via advisers, superannuation and directly.
- Reassessed our product offerings, based on customer feedback, to roll out improvements that benefit our customers. One example is our market-leading third generation funeral insurance product.

Continued...

- Invested in technology to make it easier to do business with our customers and partners. This includes a web services initiative with a key partner that makes it easier for members to apply for and make changes to their cover online and also complies with the ACORD standard.
- Provided our people with leading edge work environments, access to technology and comprehensive culture and training programs to transform the standard of customer experience Australians can expect from a leading financial services enterprise.
- Worked with Australian regulators (ASIC, APRA) and industry bodies (FSC) to help shape legislative reforms. TAL employees regularly chair committees and attend forums, committee activities and working groups in order to understand and implement new laws.
- Signed the United Nation's Principles for Sustainable Insurance in 2012, becoming the first Australian life insurer to do so. The UNPSI is a sustainability framework for the global insurance industry and part of the UN's Environment Program Finance Initiative (UNEP FI).

We welcome the Inquiry as an opportunity for Government and our industry to take a more expansive view of the financial system in Australia. To ensure delivery of longevity products, legislative and taxation changes may well be required. This Inquiry will allow all participants to step back and examine how effective the reforms of recent years have been.

Please do not hesitate to contact me should you wish to discuss any aspect of this submission.

Yours sincerely

Jim Minto
Group CEO and Managing Director

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Executive summary

TAL is proud of the proactive approach it has taken to recognise and adapt to the community and market in which it operates. The market is undergoing a period of rapid structural change that is having an impact on the industry's capacity and sustainability.

We believe it is important to highlight some of these changes. They include:

- Consolidation in the superannuation market, leading to many fewer and much larger superannuation funds. We expect the pace of this consolidation will pick up over the next few years.
- Sustained changes in, and adoption of, technology by increasingly sophisticated consumers leading to market pressure for alternate access methods, advice models and higher service levels.
- Higher levels of insurance coverage, especially default insurance.
- Expansion of cover for total and permanent disability benefits (TPD) as a result of the requirement to offer TPD to all MySuper members.
- A significant change to the volume, frequency and type of claims made.
- Increasing awareness of the importance of data quality in assessing and pricing risk in group insurance schemes.
- Vertical integration in the financial advice sector due to the Future of Financial Advice (FoFA) reforms.
- Significant increases in claims levels and pricing increases by group life insurers and reinsurers.
- Increased involvement of plaintiff law firms.
- These observations inform the recommendations in our submission as summarised on page 4.

Recommendations

Terms of reference 1

- Consider legislative amendment of section 54 of the Insurance Contracts Act so that it does not apply to late notification in 'living benefit' policies.

Terms of reference 2

- Review the roles of the Australian Securities and Investments Commission (ASIC) and the Australian Prudential Regulation Authority (APRA) to ensure that any overlap in areas of regulation can be minimised.

Terms of reference 3

- Ensure the regulatory settings for privacy and the delivery of financial services reflect the digital environment and the increasingly globalised industry.
- Consider proposals to amend the current regulatory settings in the Life Insurance Act and the associated prudential standard in relation to the requirement for surrender values in annuity products.
- Increase the maximum tenure of Commonwealth bonds (currently 20 years).
- Take steps to encourage greater use of corporate bonds.
- Introduce more flexibility in the annuity rules in the Superannuation Industry Supervision (SIS) Regulations to enable a wider range of income-stream products in drawdown to achieve tax neutrality.
- Remove artificial distinctions between general, life and health insurance in particular to allow life insurers to offer return to work services.
- Align regulation of insurers to improve flexibility and competition in the insurance market.
- Provide APRA with wider powers to allow insurers to provide ancillary benefits.

Terms of reference 4

- Expand 'Insured benefit' provision in 4.07E of the Superannuation Industry (Supervision) Regulations 1994.
- Consider initiatives to address the major public health issues of obesity and mental health.
- Consider a proposal to allow life insurance product rationalisation with appropriate safeguards.
- Consider allowing advice fees to be tax deductible to encourage more consumers to seek advisers offering this option.
- Consider making the requirement of a minimum termination value on long term risk business optional, on an 'opt out' basis, so that that the provision of level premium risk products are more affordable for a greater number of Australians.
- For categories such as funeral plan policies sold to people on benefits or fixed incomes only level premiums should be allowed. APRA as regulator should set appropriate rules for design of these policies.
- TAL supports FoFA to allow greater ease of advice but believes some further policy changes will be needed with regards to providing general advice to address consumer requirements for more flexibility.

Terms of reference 5

- Allow tax deductibility for life insurance and TPD premiums outside superannuation.
- Abolish stamp duty on life insurance or alternatively standardise all stamp duty arrangements between states and territories to remove complexity and cost.

Terms of reference 1

The inquiry will report on the consequences of developments in the Australian financial system since the 1997 Financial System Inquiry and the global financial crisis, including implications for:

1. How Australia funds its growth;
2. Domestic competition and international competitiveness; and
3. The current cost, quality, safety and availability of financial services, products and capital for users.

Insurance Contracts Act

One of the current challenges for insurers in the disability market is late notified claims, especially for total and permanent disability benefits (TPD). TAL and others are experiencing an increase in late notified disability claims, sometimes eight to 10 years and longer after the insured customer has stopped working. Late notified TPD claims are particularly difficult to assess, as the insurer must form a view on what the customer's condition was as at a much earlier date, typically six months after stopping work. This leads to difficulties for both parties, as evidence of the customer's condition at that time is usually scarce. It also creates difficulties for insurers in calculating their 'incurred but not received' reserves and capital needs. The result is customers pay higher premiums for disability cover, which affects its affordability.

Ideally, insurers should be able to place a time limit on when TPD claims can be lodged. We believe that a difficulty with this approach relates to section 54 of the Insurance Contracts Act. Section 54 provides, in summary, that the insurer may not rely on an act or omission of the insured to refuse to pay a claim, unless the act or omission prejudices the interests of the insurer, in which case the benefit may be reduced proportionately. The purpose of s 54 is to prevent an insurer relying on a minor contractual transgression by the insured to deny a claim. It was introduced mainly to address issues arising in general insurance policies; however, it also affects life insurance policies.

This provision has been subject to wide interpretation by the courts. One such interpretation relates to *FAI General Insurance Co Ltd v Australian Hospital Care Pty Ltd (2001) 204 CLR 641*. The High Court in this instance held that s 54 may be relied on to prevent the denial of a claim if it is notified late, even for a 'claims made and notified' policy.

The Hospital Care case indicates that simply inserting a time limit for lodgement of claims into policies is potentially ineffective to prevent late notified claims.

This problem can now only be resolved by the Government amending s 54, in the absence of another case before the High Court in which it over-rules its previous decision in *Hospital Care*. A number of reviews of the Insurance Contracts Act have noted the difficulties associated with s 54, but these have not led to law reform in this area. One option might be an amendment to s 54 so that it does not apply to late notification in 'living benefit' policies.

Recommendation

- Consider legislative amendment of section 54 of the Insurance Contracts Act so that it does not apply to late notification in 'living benefit' policies.

Terms of reference 2

The Inquiry will refresh the philosophy, principles and objectives underpinning the development of a well-functioning financial system, including:

1. Balancing competition, innovation, efficiency, stability and consumer protection;
2. How financial risk is allocated and systemic risk is managed;
3. Assessing the effectiveness and need for financial regulation, including its impact on costs, flexibility, innovation, industry and among users;
4. The role of Government; and
5. The role, objectives, funding and performance of financial regulators including an international comparison.

TAL strongly supports the 'twin peaks' regime which resulted from the Wallis inquiry. This model generally served Australia well through the global financial crisis. However, we believe that the current Inquiry provides an opportunity to review the roles of the Australian Securities and Investments Commission (ASIC) and the Australian Prudential Regulation Authority (APRA) to ensure that any overlap in areas of regulation can be minimised.

Principles-based regulation should be the guiding philosophy behind industry rules, especially in relation to APRA. With this in mind, the standard-making power of APRA should be reviewed to ensure that the industry is not unduly constrained by compliance rules.

Recommendation

- Review the roles of the Australian Securities and Investments Commission (ASIC) and the Australian Prudential Regulation Authority (APRA) to ensure that any overlap in areas of regulation can be minimised.

Terms of reference 3

The inquiry will identify and consider the emerging opportunities and challenges that are likely to drive further change in the global and domestic financial system, including:

1. The role and impact of new technologies, market innovations and changing consumer preferences and demography;
2. International integration, including international financial regulation;
3. Changes in the way Australia sources and distributes capital, including the intermediation of savings through banks, non-bank financial institutions, insurance companies, superannuation funds and capital markets;
4. Changing organisational structures in the financial sector;
5. Corporate governance structures across the financial system and how they affect stakeholder interests; and
6. Developments in the payment system.

New technologies and the impact on customers

The digital economy continues to evolve along with developments in infrastructure (broadband) and technologies (smartphones and tablets).

In 2014 the percentage of Australian households with internet connections is 80% (up from 53% in 2003). Broadband and mobile are increasingly replacing dial-up as the dominant connection mechanism. Additionally, the adoption of tablets continues to increase (according to Nielsen's multi-screen report) with 33% of households owning a tablet in June 2013, up from 19% the year prior.

The impact of our adoption of technology is flowing through to how consumers research, access, purchase and use products. The increase in the availability of information has had a profound impact on consumer education and decision making. Our research informs us that 47% of smartphone users use their mobile device when researching a product or service and 25% use it to transact.

The life insurance sector is experiencing similar changes in consumer behaviour. Research conducted by Google (February 2013) into life insurance indicates that more and more consumers are migrating online; 58% searched online, 59% used a provider's website and 60% made comparisons online.

In response, TAL has introduced a strategy to embed digital technology across the value chain of our business. Our business-to-business (B2B) capabilities include one of the market's most sophisticated online risk assessment underwriting rules engines. Moreover, our recent implementation of web services to support B2B underwriting and claims enable our industry fund partners to interact with us in a secure, 'real time' environment.

For direct-to-customers channels TAL focuses on providing the best-possible multi-channel experience in accessing insurance products and services. Our direct businesses, InsuranceLine and comparator Lifebroker, have mobile-enabled sites that facilitate quick, convenient access to our services and a variety of competitor products in the case of Lifebroker.

We submit that regulatory and policy enhancements should be allowed to remain neutral and accommodate greater use of web-based technologies and the increasing desire of consumers to research, access, purchase and manage their life insurance in a digital environment. The financial services market is increasingly globalised. For example all reinsurers in Australia are owned by foreign institutions and retrocede (transfer) risk to their offshore parents. The regulatory settings for privacy and the delivery of financial services need to reflect this globalisation.

The longevity challenge

As Australians are living longer, more and more self-funded retirees run the risk of using up their retirement savings and having to rely on the Government pension. This represents a tremendous challenge to Government and the life insurance industry: to develop appropriate products that will provide sufficient income for retirees in later years when their lump-sum entitlements have been spent.

Some broad observations:

- One of the original objectives of compulsory superannuation was to increase national savings. Since the introduction of the Superannuation Guarantee Act in 1992, assets have grown by $1.4 trillion ($0.2 trillion in 1992 to $1.6 trillion in 2013[1]). This has been accompanied by growth in household debt of $1.5 trillion over the same period (from $0.3 trillion in 1992 to $1.8 trillion in 2013[2]).
- There has been some evidence that growing numbers of people are reaching retirement age with substantial debt and are using super to pay it off [3]. This indicates that superannuation is not meeting its original objective to provide retirement income.
- Australia retirement income policy has not kept pace with changing population demographics and the consequent longevity risk.
- The superannuation system is not integrated with aged care.

In the context of these observations, some potential areas for policy reform are identified below.

TAL welcomed the announcement in the May 2013 Federal Budget of an amendment to the taxation laws giving tax-free status to investment income earned on amounts invested to purchase deferred lifetime annuities. This change in effect was to allow these products to be treated neutrally in a tax sense with superannuation in drawdown mode. Under existing rules, this income would be taxed at the 15% rate applicable to superannuation funds. We urge the Inquiry to support this measure, which is a first step in the journey to finding solutions to the problem of retirees outliving their retirement savings.

However, current regulatory settings require that deferred lifetime annuities must have a minimum surrender value. This makes them more expensive and reduces the benefits of 'pooling' longevity risk. Providers should have the choice of allowing customers to either have minimum surrender values or to choose not to have them and so benefit from a lower cost. We suggest that the Inquiry consider proposals to amend the current regulatory settings in the Life Insurance Act and the associated prudential standard.

Issuers of annuity products face challenges in sourcing long-dated investments to back them. We suggest that the Inquiry consider funding for such products and, in particular:

- Increase the maximum tenure of Commonwealth bonds (currently 20 years).
- Take steps to encourage greater use of corporate bonds.
- Introduce more flexibility in the annuity rules in the Superannuation Industry Supervision (SIS) Regulations to enable a wider range of income-stream products to enjoy tax-free status or concessional tax status.

Steps to encourage more innovation in the insurance market

The insurance market in Australia is regulated by various acts of parliament and regulations and standards made under those acts. These include:

- The Life Insurance Act 1995, under which life insurers are registered and regulated from a prudential perspective.
- The Insurance Act 1973, under which general insurers are registered and prudentially regulated.
- The Insurance Contracts Act 1984 which governs contracts between insurers, policy owners and beneficiaries.
- Chapter 7 of the Corporations Act 2001 which provides for licensing of financial service providers and consumer protection measures.
- The Private Health Insurance Act 2007, under which private health insurers are registered and regulated. Unlike other insurers, the private health insurance industry is not regulated by the APRA, the Insurance Contracts Act or the Corporations Act.

The Life Insurance Act contains specific definitions of what constitutes a life insurance policy, as does the Private Health Insurance Act in relation to private health insurance policies. The General Insurance Act contains no specific definitions. Therefore, insurance business that is not defined as either life insurance or health insurance will generally default to be regulated as general insurance under the Insurance Act.

It is illegal to operate an insurance business in Australia without registration under the relevant legislation.

The Private Health Insurance Act seeks to distinguish between health insurance and benefits that are commonly offered in life insurance policies. The Act, and Private Health Insurance Business Rules, are convoluted and difficult to interpret. It can therefore be difficult to determine whether a benefit should properly be classified as health or life insurance. Life insurers are limited by the Private Health Insurance Act in their ability to offer a true return-to-work service. This limits life insurers' ability to pay for medical expenses or other ancillary benefits.

The Life Insurance Act contains provisions under which APRA can determine that a benefit may be offered as part of a life insurance policy, although it may not satisfy the strict definition of life insurance in the Life Insurance Act. In recent years, APRA's policy is to restrict the exercise of this power to very narrow circumstances.

[1] APRA Annual Statistical Bulletin June 2013 and Australian Parliament House Library "Chronology of superannuation and retirement income in Australia" (2010)
[2] ABS 5232.0 Table 20
[3] AMP NATSEM "Lump Sum: here today gone tomorrow – March 2004"

The aims of life and health insurance are often aligned, in that life and health insurers and customers have an interest in the maintenance of good health and ready access to services that assist return to health and a productive lifestyle.

We submit that:

- The interests of consumers would be better served if the artificial distinctions between general, life and health insurance were made more flexible.
- The regulation of all insurers should be aligned to the greatest extent possible.
- APRA should have wider powers to allow insurers to provide ancillary benefits or 'riders' which would assist customers to return to health and take an active part in the economy.

These steps would encourage more competition, innovation and better access to services for consumers.

Recommendations

- Ensure the regulatory settings for privacy and the delivery of financial services reflect the digital environment and the increasingly globalised industry.
- Consider proposals to amend the current regulatory settings in the Life Insurance Act and the associated prudential standard in relation to the requirement for surrender values in annuity products.
- Increase the maximum tenure of Commonwealth bonds (currently 20 years).
- Take steps to encourage greater use of corporate bonds.
- Introduce more flexibility in the annuity rules in the Superannuation Industry Supervision (SIS) regulations to enable a wider range of income-stream products in drawdown to achieve tax neutrality.
- Remove artificial distinctions between general, life and health insurance in particular to allow life insurers to offer return to work services.
- Align regulation of insurers to improve flexibility and competition in the insurance market.
- Provide APRA with wider powers to allow insurers to provide ancillary benefits.

Terms of reference 4

The Inquiry will recommend policy options that:

1. Promote a competitive and stable financial system that contributes to Australia's productivity growth;
2. Promote the efficient allocation of capital and cost efficient access and services for users;
3. Meet the needs of users with appropriate financial products and services;
4. Create an environment conducive to dynamic and innovative financial services providers; and
5. Relate to other matters that fall within these terms of reference.

Trustees and self-insurance

As part of super reforms, trustees will be prohibited from self-insuring any 'insured benefit,' by Regulation 4.07E of the Superannuation Industry (Supervision) Regulations 1994.

'Insured benefit' is defined in Regulation 4.07C which states: 'insured benefit, for a member, means a right, other than an anti-detriment payment, for the member's benefits to be increased on the realisation of a risk'.

We believe that in order to improve the sustainability and affordability of insurance benefits, this provision should be expanded to make it clear that where a trustee shares in experience risk or profitability of an insurance scheme, this is not to be taken as self-insurance.

Public health issues

Major public health issues affect Australian society. Two key issues are:

- Obesity, which leads to complications such as cardio-vascular disease, diabetes and joint injury.
- Mental health conditions, especially depression. Statistics sourced from the Australian Bureau of Statistics substantiate the growing impact – in 2001 9.6% of Australians were identified as suffering from a mental health condition. This increased to 11.2% in 2007-8 and to 13.6% (or 3 million people) in 2011-12.

It is clear that these issues will continue to have a major impact on Australians, their families and their ability to contribute effectively to the economy. In addition, the cost to the community of caring for these individuals is immense and increasing.

We believe that major public health issues such as these should be addressed at a national level. We suggest that the Inquiry consider initiatives to address them, including:

- Joint government, industry and professional forum.
- Awareness campaigns.
- Investment in measures to help prevent these conditions.

The Inquiry represents an important opportunity to raise the profile of these issues in national debate. Due to their complexity (in particular mental health) we believe that there should be multi-sector representation in a joint government, industry and professional forum, in which TAL would be willing to participate actively.

Life insurance product rationalisation

The taxation and financial services legislation should contain measures to facilitate the closing of obsolete financial service products and move consumers into more modern alternative products which are better suited to their needs.

The financial services sector over the years has introduced a range of products, along with their administrative systems, that have become obsolete as a result of legislative changes and shifts in consumer sentiment.

The continued operation of these legacy products not only increases the cost burden on consumers 'trapped' in out-of-date products, it also results in inefficient use of capital in the financial sector. The risks associated with this situation could be mitigated by legislative measures to facilitate the closure of obsolete products and movement of customers into more modern competitive products. These measures would of course require sufficient consumer protection and appropriate compensation measures for those prejudiced by the rationalisation.

On the taxation side, the rationalisation measures should include capital gains tax roll-over relief covering the transfer of assets, and tax exemption for consumers when their investments are transferred to a new product.

In previous years there were extensive discussions between regulators, the financial services industry, and other interested groups on the scope and extent of product rationalisation measures. These discussions have not progressed for a variety of reasons, and the initiative is now dormant.

There is a very considerable public benefit from allowing many legacy customer groups to have their policies merged onto more modern policies subject to safeguards so that they will not be disadvantaged.

TAL proposes that life insurance product rationalisation proposals should be allowed by special application to the Federal Court of Australia that does not require the application or approval of APRA but that APRA can participate as an interested party if it wishes.

These would cover in essence:

- A scheme of product rationalisation proposal from the life company where the test of the scheme acceptability would be 'the best interests of policyholders affected as a group'.
- An expert opinion on the company proposal.
- An expert opinion for policyholders from a court appointed person.
- Notification to all interested parties and a right for interested parties to participate.
- Costs to be paid by the life company.

We submit that the Inquiry should recommend adoption of this proposal regarding court-approved product rationalisation schemes.

Commission structures

TAL continues to support commissions on life insurance products as a practical way to increase Australians' access to quality financial advice. While some consumers will have simple needs, there remain a significant number for whom the complexity of their personal financial circumstances, their attitudes towards managing risks or their personal preferences will motivate them to seek advice from a professional.

An issue commonly raised with respect to commissions is that of alignment between the life insurer, adviser and consumer. We believe the best solution is a competitive, self-regulating market that provides a range of compelling customer propositions. Indeed there is evidence that this is happening:

- The range of commission-free insurance options, predominantly provided under a direct distribution, no-advice model, is growing.
- A growing number of fee-for-service advice businesses provide comprehensive advice and insurance solutions without commissions; these compete directly with commission-based advice businesses.

- Over several years, TAL has increased the amount of business written under hybrid commission structures (lower up-front, higher trail) and now writes a significant proportion of its business under this model. Some competitors have also recently taken steps to adopt similar commission models.

Finally, the fee-for-service model referred to above is currently at a disadvantage with respect to tax deductibility of costs. As disability (income protection) insurance premiums are tax deductible (as are, by extension, the commissions paid implicitly in those premiums) there is a consumer benefit that does not extend to fee-for-service advice fees.

We believe a more equitable position would be to allow advice fees to be tax deductible which would encourage more consumers to seek advisers offering this option and thus increase competitive pressure in the market. We ask that the Inquiry supports this proposal.

Encouraging level premiums

Yearly Renewable (or "stepped premium") insurance dominates the Australian market. This type of product is characterised by premiums that increase with age, and in some cases duration, and does not require a minimum termination value. This means that while premiums may be low at younger ages, they increase substantially over time. At older ages, particularly post-retirement, the increase in the premium year can become prohibitive at a time when the individual is no longer working and least able to afford the increases.

The domination of stepped premium products is a somewhat unique feature of the Australian market compared with other western countries. Stepped premiums are very suitable for some consumers but highly unsuitable for others.

Level premium insurance provides a great level of predictability, allowing people to better plan for the ongoing cost, and the cover is likely to remain more affordable at older ages.

Current regulation (Prudential Standard LPS 360) defines insurance business to be Long Term Risk where the term is greater than 15 years, the age at expiry is greater than 70, premiums are level and the sum insured is more than $15,000. Long term risk business is required to provide a Minimum Termination Value which is a cash benefit payable to the policyholder at any time they discontinue the policy.

Even with the best of foresight, personal circumstances can change over time, and the above requirement is intended to safeguard the policyholder in the event that for whatever reason they discontinue a long term contract through receiving a cash payment. However this 'cashback' requirement comes with a higher premium cost which can be significant and hence level premium products can be less affordable for lower income Australians. This means that they may not be able to afford a product which is more suited to their needs, and instead for reasons of price choose a yearly renewable term product which becomes less affordable over time.

TAL recommends that the requirement for a minimum termination value on Long Term Risk business be optional for policyholders individually, on an 'opt out' basis, in order that the provision of level premium risk products be more affordable for a greater number of Australians.

This would allow product designs to emerge for long term risk where customers have the right to choose an alternative product. Alternative designs may include the provision of a paid up value when a policyholder discontinues, still entitling them to receive an ongoing benefit albeit at a lower level.

There is also a very significant benefit from level premiums for customers who have low or fixed incomes and who need to budget with certainty. In this context, there is a role for level premiums based on level or cover and/or customer needs. TAL has, with funeral policies for instance, now changed to only provide level premium products. There has been a lot of adverse media and challenge to life insurers from ASIC, media and consumer groups regarding the unintended consequences of stepped premium products for people on fixed incomes and TAL agrees with these views.

TAL recommends that for categories such as funeral plan policies sold to people on benefits or fixed incomes only level premiums should be allowed. APRA as regulator should set appropriate rules for design of these policies.

Improved regulation for direct life insurance

TAL has been one of the pioneers of direct-to-consumer life insurance in Australia and remains the market leader in this channel.

The direct life industry has played a critical role in promoting life insurance amongst Australians. Collectively this direct industry has made a significant investment in educating the Australian public about the role life insurance can play in meeting their basic needs for protection. There is no doubt that the wider life insurance industry has benefited from the role played by the direct channel.

Direct insurance plays a key role in extending the market to people who are willing and able to access life insurance protection independently via the channel of their choice and who have access to advisers or feel comfortable accessing insurance through advisers.

We believe there is a place for all channels in the life insurance market and customers will choose the access pathway that best meets their needs. It is important that the regulatory framework continues to support and facilitate the provision of life insurance through direct to consumer channels, and the use of new technologies to meet consumers' needs. Consumers increasingly expect to research information and buy financial products at a time most convenient to them, using channels of their choice.

In TAL's view, there is a need to continue to improve the ability of financial services industry participants to provide simple life insurance products to Australians, many of whom remain under-insured. The laws pre the FoFA announcements prevented participants from providing basic levels of simple advice which consumers are requesting and expecting.

Many consumers who buy directly from TAL, via a phone call or online, indicate that they would like the licensee to recommend an appropriate level of cover, or provide some guidance on appropriate product options. Under a General Advice authorisation, we are unable to meet these basic requests. The solution is not necessarily for the licensee to get such authorisation, because these customers are typically not seeking or prepared to participate in a personal advice process (such as that required for an advisor to make reasonable enquiries, give appropriate warnings and provide a Statement of Advice). Consumers are simply seeking a quick response about what cover they may need.

Ideally TAL would like more flexibility under a General Advice regime to better serve these customer needs for greater questioning and assessment based on needs at time of purchase. TAL supports FoFA to allow greater ease of advice but believes some further policy changes will be needed to address these consumer requirements without imposing the need to have full personal advice on these types of customers.

Recommendations

- Expand 'Insured benefit' provision in 4.07E of the Superannuation Industry (Supervision) Regulations 1994.
- Consider initiatives to address the major public health issues of obesity and mental health.
- Consider a proposal to allow life insurance product rationalisation with appropriate safeguards.
- Consider allowing advice fees to be tax deductible to encourage more consumers to seek advisers offering this option.
- Consider making the requirement of a minimum termination value on long term risk business optional, on an 'opt out' basis, so that that the provision of level premium risk products are more affordable for a greater number of Australians.
- For categories such as funeral plan policies sold to people on benefits or fixed incomes only level premiums should be allowed. APRA as regulator should set appropriate rules for design of these policies.
- TAL supports FoFA to allow greater ease of advice but believes some further policy changes will be needed with regards to providing general advice to address consumer requirements for more flexibility.

Terms of reference 5

The Inquiry will take account of the regulation of the general operation of companies and trusts to the extent this impinges on the efficiency and effective allocation of capital within the financial system.

Tax treatment of life insurance products

It is well documented that Australian consumers are under-insured for life protection. Tax deductibility for the cost of risk insurance would greatly help to rectify matters.

The existing taxation system does not offer deductions for the cost of death and TPD (total and permanent disability) insurance premiums outside superannuation. The cost of life insurance within superannuation is effectively tax deductible to the consumer who is financing the cost of such insurance via tax deductible contributions, or in the case of employees, via salary sacrificed contributions.

The existing system therefore creates a bias in favour of life insurance offerings via superannuation, and the insurance premiums within superannuation are eroding retirement savings. We believe that there should be consistent treatment of life insurance premiums and claim proceeds inside and outside superannuation.

TAL recommends this be achieved by allowing tax deductibility for life insurance and TPD premiums outside superannuation. Claim proceeds should also be treated consistently under both structures. An alternative to the tax deduction would be granting a rebate against the consumer's tax liability.

Consistency of tax treatment of life insurance inside and outside superannuation will ensure that tax is not a factor in the consumer's decision to have life insurance inside or outside superannuation.

Many consumers do not want to use their superannuation earnings to pay life insurance premiums, and would prefer to grow their savings in superannuation at a faster rate. The present system discriminates against consumers making this choice.

Removal of state taxes on life insurance

The Henry Review advocated the removal of state taxes on life insurance products. A similar recommendation was made in the Johnson Report. It is generally accepted that stamp duty on life insurance is an inappropriate tax. This impost represents a substantial portion of the life insurance premium (up to 11%), and increases the cost of life insurance substantially for the consumer. It also adds to the compliance burden for life insurers.

TAL spends approximately $20 million in stamp duties and considerable time and effort in compliance with the myriad of stamp duty systems and rates across Australia's eight stamp duty jurisdictions. The ACT Government moved last year to phase out its life insurance stamp duty as well as some others in recognition of making them 'fairer, simpler and more efficient'. It is accepted that the abolition of stamp duty on life insurance presents difficulty for any Federal Government, as it would have to negotiate alternate sources of revenue for the states and territories.

TAL recommends considering the abolition of stamp duty or alternatively standardise all stamp duty arrangements between states and territories to remove complexity and cost.

Recommendations

- Allow tax deductibility for life insurance and TPD premiums outside superannuation.
- Abolish stamp duty on life insurance or alternatively standardise all stamp duty arrangements between states and territories to remove complexity and cost.

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