

**ALLIANZ**

**AUSTRALIA  
INSURANCE  
LIMITED  
SUBMISSION**

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

*11 October 2018*

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**Senate Standing Committees on Economics**  
**PO Box 6100**  
**Parliament House**  
**Canberra ACT 2600**

**By email (Word and PDF formats)**

[economics.sen@aph.gov.au](mailto:economics.sen@aph.gov.au)

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

**1. ABOUT ALLIANZ AUSTRALIA INSURANCE LIMITED**

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

**2. SUMMARY OF SUBMISSION**

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

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

The proposed changes deal with important matters worthy of consideration and which Allianz has already started to embed in our business. For example, as part of our product governance framework, we seek to understand whether a product satisfies the needs of customers in an identified target market with particular emphasis on making sure that our products are of value and suitable for our customers. This process has already started to deliver some benefits for our business but it has also revealed some challenges.

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

One issue raised in the Interim report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry is whether a complex regulatory regime serves consumers well and whether law should be kept simple to reflect the key objectives of legislation more clearly and avoid confusion.

Most of the issues in this submission are raised with this objective in mind.

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

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

Allianz is concerned that in consultation between Treasury, ASIC, consumer groups and industry, no one group could agree on what ‘level’ the target market should be. We provide practical examples in this submission of the difficulties faced.

The change from an earlier draft of the Bill to add the following bold words to the description has not improved things: “class of retail clients that comprises the target market (**within the ordinary meaning of the term**) for the product”.

Unless one can properly determine the target market, which in is not reasonably possible based on the current Bill, an insurer has no reasonable compliance certainty as to whether it’s TMD has been correctly made or whether it is appropriate. Significant civil and criminal penalties apply if this is not the case.

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

Guidance would be best provided in the Explanatory Memorandum (EM) and through regulations setting out the expected target market ‘level’ for each type of product.

Package policies (ie those providing a mix of retail and wholesale covers (eg motor vehicle, sickness and accident, property damage, liability)) provide a particular challenge for insurers and having further clarity on how package policies are to be treated in the operation of the Appropriateness Test will be key to a successful implementation of the changes.

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

Below we provide further detail on these and other issues.

### 3. KEY ISSUES

#### Type of insurance products caught

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

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

#### *Packaged policies*

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

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

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

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

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

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

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

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

As the Bill is currently drafted, it is unlikely that insurers will be able, with any certainty, to determine how they can reasonably describe the class of retail clients that comprise the target market for the product.

An insurer is required to describe the “class of retail clients that comprises the target market **(within the ordinary meaning of the term)** for the product” [our emphasis] in an insurance context. The bold words were added after consultation but have added very little clarity.

There is no guidance in the Explanatory Memorandum (EM) or elsewhere on what this practically would mean in an insurance context. The EM simply states in footnote 28: “The target market is to be described according to the ordinary meaning of the term.” Insurers will

therefore take different approaches, generating inconsistency across the industry and creating confusion for customers.

While understand that a level of granularity is expected to identify a target market. For example, the TDM for a motor vehicle insurance product is expected to be more detailed than just “anyone with an insurable interest in a motor vehicle”. However, there is no guidance in the draft or EM around the expectations of the level to which a target market must be defined for mass market products that are suitable for broad categories of consumers.

For example, a stakeholder view was expressed at a recent consultation, that included Treasury and ASIC, that the target market for motor vehicle insurance must go to the level of those consumers who should have a specific amount of excess (ie the first part of the loss retained by the insured). This would appear to take granularity to the extreme and a more pragmatic approach is needed.

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

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

Due to the unique nature of general insurance, there is a need for guidance/rules in the EM as well as in the legislation or regulation on the issues of the expected level of TDMs and the scalability of the obligations. It is currently common practice in the Corporations Act to include provisions specific to insurance, separate to investment and other financial products. Regulation making powers in relevant parts of the Bill and regulations should specify the level of target market identification appropriate for each retail product.

Without such clarity, insurers may be forced to introduce complex levels of compliance that will either result in more limited product offerings or more expensive insurance or both. Systems change costs will also be significant depending on the level to which a target market must be determined adding further cost if target market determinations are unnecessarily granular.

We also suggest that any transition period not commence until such regulations are made or guidance is otherwise provided.

Consideration should also be given to whether certain core products (eg standard cover such as motor and home insurance) should be excluded from the requirements and the review of standard cover currently under consideration by Treasury be used to achieve reasonable and cost effective protection.

### **Distribution Conditions**

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

The distribution conditions must be designed to ensure the insurer can satisfy s994B(8) (the appropriateness test – see below), that is, that it would be reasonable to conclude that if the

product were issued to a retail client in accordance with the distribution conditions, that it would be likely that the retail client is in the target market.

The issue, as discussed above, is the determination of who comprises the target market. Without knowing where the target market identification line is drawn, this is difficult to safely determine the appropriate Distribution Conditions.

For example, if the target market for a motor policy is a person with a car, the distribution conditions are relatively simple, for example, it could be achieved by building in a 'knock out' question preventing the issuing of a policy where the person does not own a car.

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

If the TMD is not practical, pragmatic and defined at a high level, the distribution conditions would be highly complex and TMDs would be very long and contain detailed underwriting rules. This could also result in confidential or commercially sensitive underwriting information being made available to competitors.

We also note that we cannot know a customer's needs with any certainty and the legislation should not be so restrictive as to prevent customers having access to a product that they need. For example, despite being a non-target, a person may want the product for reasons specific to their circumstances. An insurer may have no knowledge of these circumstances (as insurers generally do not provide personal advice) and by restricting their choice, customer risk not obtaining the protection that best suits their needs.

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

A practical balance between defining target markets and ensuring customers' needs are met is critical. A reasonable and fair safe harbour concept needs to be built into the legislation.

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

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

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

In addition and as noted above, without clarity about the expected level at which the TMD should be set, it is not possible to easily determine the distribution conditions that would allow for this appropriateness test to be met. Significant civil and criminal penalties apply if a TMD is not appropriate;

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

The EM provides by way of explanation:

*“1.55 The second requirement focuses on the likelihood of a product being appropriate for the retail clients in the target market. Whether a product is appropriate is determined by reference to whether it is likely to be consistent with the likely objectives, financial situation and needs of **the retail clients**. Again, this formulation provides flexibility to an issuer in determining the appropriate target market for a product. For example, it would enable an issuer to conclude that it is appropriate for a product to be issued to an investor as part of balanced portfolio, even if it would not otherwise be appropriate for the investor. [Schedule 1, item 5, paragraph 994B(8)(b) of the Corporations Act]” [emphasis added].*

*1.531.56 The amendments use language similar to that currently used in the Corporations Act in the context of personal advice. In particular, it must be reasonable to conclude that if the product were issued or sold it would “likely be consistent with the likely objectives, financial situations and needs of **persons in the target market**”*

The intent is clearly that the retail client buying the product is likely to at least have the identified objectives and needs **of the retail client target market** the insurer is seeking to meet, that is, that they should come within the defined target market.

The provision seems inconsistent with this expressed intent as it clearly refers to the objectives, financial situation and needs of “*the retail client*” (ie the individual) being met. This needs to be amended to reflect the actual intent because to determine the likely objectives, financial situation and needs of the individual retail client is clearly not possible.

## **New Business Issue**

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

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

As a result, a higher target market level will enable a better customer experience.

## **Renewal Issue**

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

Many insurers that issue retail insurance that is renewable (eg car, home, contents, sickness and accident etc), agree with insureds on an automatic renewal process. For customers that pay by instalment, a renewal invitation is given to them at least 14 days prior to renewal (usually longer), attaching the schedule for the new period of insurance. Unless otherwise advised by the customer, the insurer offers renewal and will automatically renew the policy

on the terms offered. In some cases, the insurer relies on a non-response from the insured as confirmation that no changes to disclosed circumstances have occurred that may impact the risk. There are real benefits in this process for insureds in terms of time savings and reduced risk of being left uninsured.

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

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

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

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

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

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

IT systems changes to implement our proposed streamlined renewal mechanism are likely to cost around \$15 million for Allianz alone. If this mechanism was not implemented, the ongoing costs to insurers of forcing the customer contact them on every renewal would cost significantly more. More burdensome alternatives would be even more costly, which would have to be passed on to consumers through higher premiums.

### **“Excluded dealing”**

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

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

the regulated person will be in breach unless the retail product distribution conduct is excluded conduct or falls within the new exception on s994E(6) discussed below. Excluded conduct includes “excluded dealing”.



The carve out for “excluded dealing” only applies if arranging by a person is for the purpose of implementing personal advice that the person has given to the retail client. This does not take into account the situation where a customer has been given information about two or more products and received personal advice recommending product A, but the client wishes to purchase product B despite the personal advice? Alternatively, for example, the personal advice recommendation could be that a certain level of cover be obtained. The customer may choose, however, to buy a lower level of cover. In these cases, the excluded dealing carve out would seemingly not apply because the personal advice is not being ‘implemented.’

Provided the client has received personal advice as part of its decision-making process, the insurer (and broker) should be able to process the transaction whether or not the retail client has decided to act in accordance with all, part or none of that advice.

If the definition is not amended:

- an insurer would be required to consider the personal advice given by the broker to check the customer’s purchase is in fact “implementing” the personal advice. This would be unworkable in a retail client context; and
- an insurance broker would be prevented from implementing their client’s instructions where they are contrary to personal advice provided. This is not appropriate and would make the personal advice carve outs unworkable for insurance brokers.

Under s994E(1), a person who makes a TMD for a financial product must take reasonable steps that will, or are reasonably likely to, result in retail product distribution conduct in relation to the product (other than excluded conduct) being consistent with the determination.

A new carve out in s994E(6) that applies where the conduct is not excluded conduct, provides that a regulated person is not taken to have failed to take reasonable steps for the purpose of s994E(1) if the person engages in retail product distribution conduct that:

- relates to a particular retail client; and
- relates to a particular financial product; and
- is necessary to implement personal advice given to the client in relation to the product. (s994E(6))

Again, regulated persons relying on this carve would be obliged to check the personal advice received by the retail client to ensure the purchase is implementing that advice. If it isn’t in any respect (eg level of cover, optional benefits or excesses etc), the carve out would not appear to apply.

The same issue arises therefore as for the “excluded dealing” definition in relation the requirement that the personal advice needs to be ‘implemented’ and, hence, similarly needs to be addressed.

Allianz sees little point in taking such a narrow approach where the retail client is represented by a regulated person who has provided them with personal advice and the retail client chooses to only take part of this advice. In such a case, the insurer or its agent should not be subject to the relevant obligation and should be able to issue the product as requested.

## 4. OTHER ISSUES

### Record keeping and reporting - s994F and s994G

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

- until the TMD requirements are made clear, it is difficult to comment on how this will impact on insurers. It will, however, be costly for the insurer and increase costs to the consumer.
- the record keeping and reporting requirements do not take into account that there may be more than one regulated person, for example, in a coinsurance arrangement, and may result in unnecessary duplication of records and reporting.
- the reporting requirements on regulated persons apply to brokers acting for insureds, including when providing personal advice, and could create a conflict of interest or a breach of confidentiality when reporting to insurers;
- the 10 day period in which reporting is required is very short;
- we note there is an obligation on a regulated person to report to the issuer of the TMD where they engage in retail product distribution conduct in relation to the product and they become aware of a significant dealing in the product that is not consistent with the determination. Brokers providing personal advice are carved out from the retail distribution conduct obligations. If this results in clients purchasing products outside the TMD, it is not clear why such regulated persons need to report this to the insurer. Given an insurer does not need to report such notifications to ASIC under s994G, it serves little purpose. It may have the effect of increasing the cost of personal advice services for little added value as an insurer and its agents will be subject to the requirement and it is the conduct of insurers and their agents in relation to acting consistently with the TMD that the legislation is focussed on (as evidence by the personal advice carve outs). It can also give rise to conflicts of interest and breaches of confidentiality if the information reported may not be for the benefit of the customer;
- what is a significant dealing is unclear and will create confusion. Is the word “dealing” meant to be interpreted as defined in the Bill or as a general concept?

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

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

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

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

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

### **Section 1018A - advertising**

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

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

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

### **Allianz Australia Insurance Limited**

## Appendix

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

#### ***Standard motor vehicle policy.***

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

#### ***Main type of cover choice***

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

#### ***Secondary choices***

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

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

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

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

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

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

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

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

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