



ASIC

Australian Securities & Investments Commission

FINAL REPORT

NATIONAL LIFE INSURANCE DISABILITY CAMPAIGN

**National Compliance Unit
Australian Securities and Investments Commission**

February 2001

Table of Contents

FINAL REPORT:

| | |
|--|----|
| NATIONAL LIFE INSURANCE DISABILITY CAMPAIGN | 4 |
| What we did | 4 |
| Why we did it | 4 |
| How we did it | 5 |
| Our Findings | 6 |
| What we are doing now..... | 13 |
| Our recommendations – what should happen next | 14 |
| ANNEXURE A | 15 |
| BACKGROUND AND FINDINGS REPORT | 15 |
| SECTION 1: BACKGROUND | 16 |
| Introduction | 16 |
| Structure of the Report..... | 16 |
| SECTION 2: LIFE INSURANCE INDUSTRY AND DISABILITY INSURANCE | 17 |
| Life Insurance Industry | 17 |
| <i>Distribution channels</i> | 18 |
| Regulation | 18 |
| <i>Code of Practice for Advising, Selling and Complaints Handling in the Life Insurance Industry ("Life Code")</i> | 19 |
| <i>Disability Insurance</i> | 20 |
| SECTION 3: RESEARCH APPROACH | 22 |
| Overview | 22 |
| Surveillance..... | 22 |
| SECTION 4: FINDINGS | 24 |
| Overview | 24 |
| 1. Compliance and Operating Environment | 25 |
| <i>Compliance Approach</i> | 25 |
| <i>Compliance Committee</i> | 26 |

| | |
|--|-----------|
| <i>Compliance procedures</i> | 27 |
| <i>Compliance reviews</i> | 29 |
| 2. Supervision of Agents | 32 |
| <i>Remuneration</i> | 32 |
| <i>Complaints</i> | 33 |
| <i>Accountability for agent conduct</i> | 36 |
| <i>Termination of agents</i> | 37 |
| <i>Summary – Supervision</i> | 38 |
| 3. Training | 39 |
| <i>Summary – Training</i> | 41 |
| 4. Conduct Issues - Life Code | 43 |
| <i>Disclosure of Capacity</i> | 43 |
| <i>Fact Finder and Need Analysis</i> | 44 |
| <i>CAR</i> | 45 |
| <i>Duty of Disclosure</i> | 47 |
| 5. FOLLOW UP ACTION | 48 |
| What we are doing now | 50 |
| Our recommendations – what should happen next | 50 |

NATIONAL LIFE INSURANCE DISABILITY CAMPAIGN **FINAL REPORT**

What we did

Between May and September 2000, the Australian Securities & Investments Commission (ASIC) conducted a national surveillance campaign into advice and selling practices relating to disability insurance¹.

Life insurance products – such as disability insurance - are sold to retail consumers through agents and brokers. This campaign did not look at the activities of brokers. Instead it focused on training and supervision of life companies and selling practices of their agents relating to sales of disability insurance products. Agents are either *tied* to a single company or they can be *multi-agents* selling products of multiple insurance companies.

This report contains background information about the campaign as well as our key findings and recommendations. Details on the background, methodology and findings are attached at Annex A to this report.

In making these recommendations, we had regard to the conduct, disclosure and compliance requirements for both life companies and agents contained in the:

- ❑ Insurance (Agents and Brokers) Act 1984 ("IABA");
- ❑ Insurance Contracts Act 1984;
- ❑ Australian Securities and Investments Commission Act 1989; and
- ❑ Code of Practice for Advising, Selling and Complaints Handling in the Life Insurance Industry ("the Life Code").

In this report we use the term *disability insurance* to describe policies that grant a benefit if the insured becomes disabled or suffers from a medical condition specified in the policy. These include, for example, policies that provide cover for total and permanent disability and trauma as well as income protection policies.

Why we did it

Disability insurance premiums represent a significant proportion of insurance business, with consumers paying \$750 million in premiums annually. Further

¹ The surveillance was managed by the National Compliance Unit (NCU) - a specialist unit established by the Australian Securities and Investments Commission (ASIC) to undertake targeted compliance campaigns.

disability products can be very complex, with a number of different factors differentiating the various products.

A relatively large number of consumer complaints about disability insurance policies are lodged with external dispute resolution schemes each year. The Financial Industry Complaints Service has reported that the proportion of complaints that it receives about disability insurance products has increased steadily since 1996.

Consumer problems arise due to denial of an insured's claim under a disability policy, and these may be related to selling practices where agents did not adequately address the complexity of the product. The campaign looked at the agents' selling practices, provision of advice and explanation of the claims process, but did not review complaints or conduct relating to denial of claims.

In this campaign we have considered how life insurance companies and agents might improve their systems and practices for the benefit of consumers who want to buy disability insurance. If consumers clearly understand how their policy works when they purchase it - there should be fewer disputes about claims down the track.

The surveillance campaign also provided a good opportunity for ASIC to assess how industry is meeting the consumer protection requirements contained in the Life Code. Life companies were required to administer compliance with the Life Code from 1 January 1996. The Life Code consumer protection requirements cover subjects including customer fact finds, disclosure about advice, training and competency and arrangements for complaints handling.

How we did it

We chose life companies that sell disability insurance to participate in the surveillance campaign. The life companies were selected taking into account disability market share, agency structure, disability product range and location. In relation to disability products, the companies hold \$237 million in-force annual premiums, or 42% of the market.

After reviewing company specific information, ASIC staff visited each of the participating companies in May and June 2000. During these visits we asked about company training, agent supervision and consumer protection compliance.

The participating life companies also provided ASIC with information about agents who sold disability insurance across Australia. Based on this information we selected 59 agents across each State and Territory. Between July and September 2000 ASIC staff held on-site meetings with the agents during which we asked about their training, supervision and consumer protection compliance.

We also reviewed a sample of their current files (approximately 4 to 6 files per agent).

Our Findings

Our summary finding from the campaign is that while life companies have made some changes to meet consumer protection requirements through restructuring their distribution and training arrangements, these changes are not reflected in the actual level of compliance by some agents with the Life Code. This is due, in part, to inconsistencies in training and supervision by the life companies, and inadequate adoption of the consumer protection issues by life agents.

The findings that are not specific to disability insurance are based on our assessment of industry compliance with the consumer protection requirements of the Life Code. While the findings are based on our assessment of a segment of the life insurance and disability market, we believe that the issues identified should be considered by the life insurance industry generally. Our key findings are detailed below.

ASIC request for immediate compliance reviews of agents

As expressed in other parts of this report, ASIC has strong concerns about agents' conduct, advisory and sales practices. These included: failure to explain adequately products and claims handling procedures; failure to provide adequate advice about disability products and their differences; and lack of adequate record-keeping on client files.

As a result of this review, ASIC has requested that life companies conduct immediate compliance reviews of approximately one-third of the agents interviewed and report back to ASIC on action taken to address its concerns.

Advice about disability insurance

From a consumer perspective, the agent is the "face" of the life insurance company and the person from whom they are likely to get direct information about their insurance policy.

Most of the agents that we interviewed said that they provide limited or no advice to retail consumers when selling disability insurance. We also found that most life companies paid agents by commission under structures that did not reward them for advising clients – even on a limited basis. We note that where limited or no advice is given, the agent is required under the Life Code to give the customer a specific warning to this effect. These warnings should also be contained in customer advice records ("CAR"s).

The term, 'Limited advice' in the context of compliance with the Life Code

requirements, is referring to the provision of *full advice* on a limited range of products, rather than limited advice being provided about the product being advised upon.

We note that where limited or no advice is given, the agent is required under the Life Code to give the customer a specific warning to this effect. These warnings should also be contained in customer advice records ("CARs").

Because disability insurance policies are typically difficult to understand – and coverage can vary substantially between products – we are concerned that consumers may not be fully aware of the differences between available policies in the absence of any advice.

The customer files that we reviewed generally did not contain enough information for us to assess whether the product sold was reasonable for the customer or that any advice provided by the agent was adequate. And because there were few interview file notes, or CARs that were signed by customers, we could not even be sure that agents were effectively warning consumers about the risks associated with buying a policy without advice.

Of greatest concern was the lack of information in the agents' client files. It was difficult to determine whether advice was reasonable or even adequate given the lack of information on some agents' files.

Agent understanding: disability insurance and the claims process

As part of the campaign we tested agents' understanding of disability insurance. We asked them to explain clearly what *total and permanent disability (TPD)* meant in relation to the disability products offered by the life company under review.

We found that the agents we interviewed could not always adequately explain how the *TPD* definition applied in practice. And multi-agents often did not distinguish between the different treatments of *TPD* in the policies offered by the life companies they represented. This assessment exercise raises concerns about whether some agents are able to effectively answer basic questions that consumers may have about their insurance coverage.

These questions might include:

If I suffer an accident or illness will I be covered under my policy if I am unable to return to my own occupation (or another occupation for which I am reasonably suited) or any occupation at all?

In relation to the claims process, we found that agent involvement tended to be limited to helping clients obtain and complete a claims form. These agents

generally had little knowledge about the claims process. In fact, the agents of two life insurance companies consistently said that those companies provided them with very little, or no, information about the claims process.

Some agents said that they acquired knowledge about the claims process through direct involvement in claims handling. However, we found that agents with no direct claims handling experience did not demonstrate any significant understanding about the process.

We believe that agents must have a general understanding of the claims handling procedures relevant to the disability insurance policies they sell. After all – a consumer takes out such a policy for the express purpose of making a claim if and when a specific event occurs. We believe that agents should be better able to address general questions about the process of claims handling. This is consistent with expectations about agent competency under the Life Code and the proposed Corporations Law licensing requirements.

Training of agents

Life companies are responsible to ensure that their agents are adequately trained and are competent to carry out their authorised business.

Under the Life Code, agents must demonstrate that they have basic competencies. These include having product specific expertise as well as adequate knowledge about and understanding of the Life Code itself. ASIC's interim policy statement 146, *Training of authorised representatives* (IPS 146) contains further requirements about appropriate training for agents of life companies.

In summary, the Life Code and IPS 146 require that life agents:

- ❑ can demonstrate and satisfy specific competencies for the products they are authorised to sell;
- ❑ have adequate knowledge of the company's systems, forms and procedures;
- ❑ are able to conduct customer fact find and needs analysis
- ❑ understand and are able to explain the process of claims lodgment
- ❑ understand and are able to explain complaints resolution procedures

We found that most of the training provided by participating life companies was product specific, and that the emphasis given to training about disability insurance varied according to the company's product range.

More generally, deficiencies in compliance training for agents became evident when we asked agents about their knowledge of the Life Code. Knowledge of compliance requirements was poor across the agents reviewed. Just two life companies that we reviewed had a strong emphasis on skills-based

competencies, such as the Life Code requirements dealing with customer record keeping and analysis of customer needs. For the other life companies reviewed compliance training was minimal, particularly on consumer protection requirements.

The Life Code and IPS 146 also impose an obligation on life companies to carry out continuous training of their agents. Despite the fact that most of the life companies we reviewed said that the training they provided was continuous - agents were often critical of the frequency of training. Many agents said that they had not received training about disability insurance *in recent years*.

Supervision of agents

Under the Life Code, companies must have documented procedures in place to monitor the performance of their agents.

We found that the companies reviewed generally did not review their agents often enough. Some agents had only being reviewed once since the inception of the Life Code. Most of the life companies use external compliance providers to review their agents' compliance with the Life Code. The frequency of these reviews varies from two audits per year to once every three years. We found that life companies review sole agents more frequently than multi-agents.

While it may be difficult for some companies to review their agents annually if they have large numbers of multi-agents, we believe that one review every three years is inadequate. It also compares unfavourably with current practices in the securities industry.

Termination of agency agreements

Life companies are responsible for the actions of their agents. There will be circumstances in which a company seeks to terminate the agreement under which an agent operates. This may be for commercial reasons or, for example, because the agent has breached the terms of the agreement or the Life Code.

We asked participating life companies to explain what steps they take when terminating an agency agreement - both generally and where a breach of the Life Code had occurred.

We found that termination procedures varied across the life companies. Some companies follow standard procedures whereas others deal with terminations on a case-by-case basis. Typically each life company said that they would review the agent's files and other records to remedy any problems that had arisen.

Proposed best practice procedures

We would like to consider developing an industry benchmark for agency termination procedures. For example, where an agent is dismissed for suspected or actual misconduct, we believe that the life company should – as a minimum:

- ❑ review the agent's files to see if the misconduct leading to the termination was an isolated case or occurred in relation to a number of transactions.
- ❑ proactively identify other consumers that may be affected by the behaviour of the agent;
- ❑ review pre-appointment vetting procedures to determine referee checks and all other procedures were followed;
- ❑ if the terminated agent was a multi-agent, then the Life company should contact other life companies to ensure that the agent has advised that other life companies of that termination.

Please refer to *Our Recommendations* for more information about the development of industry benchmarks.

Life company compliance with the Code

We found that while the life companies that participated in the surveillance campaign have generally updated and modified their compliance systems to meet the basic requirements of the Life Code, few have improved those systems in recent years. We have identified a range of concerns specific to individual life companies. These are set out below.

Compliance Systems

One of the life companies that we reviewed was unable to provide information about changes to its compliance structure since the implementation of the Life Code. This is because the Compliance Manager was not with the company at the time. This indicates that the company has failed to document its compliance systems – and any changes to these systems over time. Another life company had made only minimal changes to its compliance system and continued to rely on agent self-assessment in relation to knowledge of the Life Code.

All of the life companies had compliance officers/managers with seniority within the company, however arrangements for providing compliance information to agents varied – with greater emphasis given to tied rather than the multi-agents.

We are also concerned by comments made by some of the agents we reviewed that – while life companies stressed the importance of compliance – guidance about how to comply (including the company's compliance manual) was not

always available or updated. Alternatively, agents did not know how to access relevant information. We believe that documented compliance procedures are critical to ensuring adequate training and supervision of agents.

Proposed best practice procedures

Based on our findings, we propose that companies' compliance systems should meet – as a minimum – the standards set out in the Australian Standard for Compliance Programs (AS 3806-1998). The Australian Standard contains guidance about the following issues:

- ❑ identifying compliance issues
- ❑ developing operating procedures for compliance
- ❑ how such procedures should be implemented
- ❑ complaints handling procedures
- ❑ methods to identify and rectify compliance failures, particularly systemic and recurring problems.
- ❑ internal reporting structures for reporting compliance issues
- ❑ appropriate management supervision of compliance.

We note that where a life company fails to produce, make available, or update its compliance manual (or equivalent) - it will not meet the acceptable compliance standard.

Please refer to *Our Recommendations* for more information about the development of industry benchmarks.

Compliance Committee

The Explanatory Memorandum to the Life Code² referred to the need for life companies to set up a Compliance Committee ("Committee")

Of the life companies we reviewed, all but one had Committees that were sub-committees of the full board. The Committees generally dealt with exception issues, such as major regulatory problems and other significant matters, issues raised in external auditor reports and complaints summary reports.

One of the main reasons a Committee is established is to make sure that senior management is fully apprised of the company's compliance performance. This includes being informed about any material or systemic breaches of the Life Code. While the life companies we reviewed said that they had detected some breaches of the Code, several had no formal procedures for referral to the Committee. Generally the breaches would be referred back to the business units for review and further action.

² Paragraph 3

We are concerned that these arrangements do not satisfy the requirements of the Life Code that all:

'serious or persistent conduct infringing this Code must be referred to the company's Compliance Committee (or to the Board of the life company) ...³.

We believe that each life company should have documented procedures for referral of such matters to the Committee.

Complaints handling

The Life Code requires that life companies must have internal complaints handling arrangements that meet minimum standards and result in complaints being handled in a timely manner. We questioned the life companies about their internal complaints handling procedures– and also looked at how life agents dealt with complaints.

All life companies that we reviewed have formal internal complaints handling arrangements, however they have made few modifications to these arrangements since the Code was introduced. The major changes reported involved a broader definition of what constitutes an eligible consumer complaint. We found that one company did not have fully documented procedures about complaints handling – especially about dealing with agents who appear to be the subject of multiple complaints.

Agent awareness about complaints handling procedures varied with the extent of their exposure to customer complaints. We believe that agents must also have a general understanding of the complaints handling procedures operated by the companies that they represent.

³ Paragraph 43

Adequacy of the Life Code

The Life Code is currently the primary regulatory standard that applies to conduct, disclosure and advice in relation to the sale of life insurance.

The Life Code was first issued as an Insurance and Superannuation Commission Circular⁴ ("ISC") with the intention that it would be included in an amendment to the Life Insurance Act (1995) in the early part of 1996.⁵ The announcement of the Financial Service Inquiry in early 1996 delayed this amendment, and the Life Code has operated without a legislative basis ever since.

As the Life Code has been in operation for almost five years, we expected substantial industry compliance with life companies seeking to incorporate additional best practices. However as we have found in this campaign, industry appears to have implemented the Life Code with varying degrees of compliance.

The campaign also confirms that the standards set out in the Life Code are clearly in need of strengthening and updating – it has not been amended since 1995. Such improvements will take place through the proposed reforms contained in the draft Financial Services Reform Bill (FSRB). Under FSRB the key requirements of the Life Code should be set out in legislation. In the interim, we will work with industry to develop best practice guidelines in the areas identified in this report.

What we are doing now

As a first step, ASIC is currently in contact with each of the life companies that participated in the review. ASIC has advised or will be advising life companies about consumer protection compliance and specific Life Code deficiencies identified during the surveillance. ASIC will also monitor and request reports from life companies about any action taken to remedy deficiencies identified.

Some of the issues that are being raised with participating life companies include the following:

- ❑ compliance structure, documentation and reporting procedures
- ❑ review of agents
- ❑ complaints and claims handling
- ❑ compliance training
- ❑ disability product knowledge
- ❑ file documentation
- ❑ use of client warnings

⁴ Circular G.II.1

⁵ Circular G.II.1, page 2 (introduction).

Our recommendations – what should happen next

We believe that consumer protection compliance issues as identified in this report must now be incorporated into the conduct, advisory and selling practices of the agents; and the training and supervision procedures of the life companies.

On this basis, we propose the following:

1. We will actively review both the life companies that participated in this review and others to ensure that best practices standards in consumer protection compliance, to be developed in conjunction with industry, are being met.
2. ASIC will publish a consumer brochure to help people buying disability insurance cover. We will also seek industry assistance to clarify and improve policy terminology and disclosure about disability insurance.
3. Training and supervision of agents appear to be deficient in a number of key areas. ASIC has announced⁶ that life companies have until 30 June 2002 to comply with requirements on the training and supervision of agents as set out in IPS 146. ASIC has also said that it will seek information from all life principals in the second half of 2001 to assess their readiness to meet the deadline. We recommend that all life companies focus on developing strategies that set out how the requirements of IPS 146 will be met.
4. ASIC will, as part of its system of quarterly National Compliance Roundtables address these issues in conjunction with industry and will suggest best practice standards in advance of FSRB implementation. Specifically, the Compliance Roundtable will address: procedures for terminating agency agreements, compliance standards and agent record-keeping practices.
5. ASIC will request the Financial Industry Complaints Service (FICS), the Superannuation Complaints Tribunal (SCT), and Insurance Enquiries and Complaints (IEC) to assess complaints handling practices in relation to disability insurance. In particular we will ask these organizations to highlight any systemic issues that may be generating consumer complaints.

⁶ Media release issued 16 August 2000

ANNEXURE A

BACKGROUND AND FINDINGS REPORT NATIONAL LIFE INSURANCE DISABILITY CAMPAIGN

Section 1: BACKGROUND

This section provides an introduction to the review and the structure of this report.

Introduction

In March 2000, the Australian Securities and Investments Commission (ASIC) announced a surveillance program focusing on advice and selling practices of life insurance companies and their agents in relation to disability insurance products. The surveillance was managed by the National Compliance Unit (NCU), a specialist unit within ASIC, established to undertake compliance campaigns on those areas within the financial services industry under ASIC's purview.

The surveillance looked at life insurance companies that provide disability insurance products and the conduct and advice practices used by agents selling those products. The focus was on consumer protection compliance, which considers how both life companies and agents comply with their obligations to ensure consumers receive appropriate advice on a complex product.

The standard for consumer protection compliance is primarily the Code of Practice for Advising, Selling and Complaints Handling in the Life Insurance Industry (the Life Code). The Life Code was the key driver in assessing conduct and disclosure in this campaign; however, all relevant regulatory requirements were reviewed.

Structure of the Report

The report is broken into five sections:

1. Background to the campaign.
2. Discussion on the legislative, compliance and product environment under review.
3. Overview of the methodology used for the campaign.
4. Discussion on the findings of the campaign, with references to ASIC policy and the regulatory environment.
5. A summary section and recommendations for change.

Section 2: Life Insurance Industry and Disability Insurance

This section sets out a summary of background material concerning the life insurance industry and disability products, with specific reference to regulation issues and operational procedures relevant to this campaign.

Life Insurance Industry

In October 1999⁷ there were 43 life companies registered with APRA. The number of life companies has been reduced over the past few years – in June 1997 there were 49 life companies registered with APRA and 44 in June 1998.

Strong merger and acquisition activity, (attributed to the perceived need by companies to gain market share and realise economies of scale⁸), has led to the top six life companies⁹ controlling approximately 65% of the industry's funds under management.

A 1998 survey conducted by Ord Minnett and Deloitte Touche Tohmatsu¹⁰ into the life insurance industry found that the industry is in the throes of reinventing itself, emerging as a purveyor of a wide range of investment and retirement products, with less emphasis on risk products. It was predicted in the outcome of the survey that within five years, multi agents would remain the most important distribution channel, with the Internet expected to move from the twelfth most important channel to fifth and direct mail from fifth to third most important.

This has been reinforced by the recent KPMG Insurance Industry Survey (2000) which found that consolidation continues to be the major focus of life companies, particularly with mergers and acquisitions¹¹. A significant impact of the merger activity in this area is the ability to cross-sell traditional risk and investment products to life office policyholders through the retail distribution networks of parent entities (such a branches of banks)¹².

The industry continues to grow in revenue, with an overall net policy cash inflow of \$5.7 billion in 1999, compared with \$5.4 billion in 1998.¹³

⁷ October 1999 was the date of the commencement for planning of the campaign. The information in this section was primarily prepared by the National Intelligence and Analysis Service ("NIAS") of ASIC.

⁸ Australian Prudential Regulation Authority, 1998b: 20

⁹ KPMG Peat Marwick, 1998:61

¹⁰ Deloitte Insurance Industry Group (1998), Broking Industry Review and Rankings, in Insurance Directions, Deloitte Touche Tohmatsu, February 1998.

¹¹ KPMG Peat Marwick, 2000.3

¹² *ibid*, 58.

¹³ *Ibid*, 63.

Distribution channels

Life insurance products are distributed either through agents or brokers. This campaign focused on the life company and agent relationship, and therefore issues relating to brokers will not be discussed.

Agents are required to hold an agency agreement with a life company before that agent can act on behalf of a life company. At the end of June 1999 there were 43,937 life agent agreements within Australia. The agency agreements are divided into two types:

- Multi agents, where the agent holds multiple agency agreements with life companies. 33,838 of the agreements entered into were multi agent agreements. Generally, the number of agreements for multi agents has remained steady or grown slightly over the past two years.
- Sole or tied agents, where the agent holds only one agreement with one life company. 10,099 of the agreements entered into were with sole agents. The overall number of sole agents has remained steady over the past two years.

Regulation

From 1 July 1998, conduct and disclosure issues relating to life companies and life insurance intermediaries (agents and brokers) came under the supervision of ASIC. All insurance matters had previously been the responsibility of the Insurance and Superannuation Commission (ISC). The ISC was abolished on 1 July 1998, due to reforms in the Australian financial system following the Financial Systems Inquiry.

Conduct and disclosure is regulated by the following Acts:

- **Insurance (Agents and Brokers) Act 1984.** This Act sets out key issues concerning the relationship between the agent and the life company, which include the following:
 - 1) ***Section 13: Representations.*** Section 13(1) requires that intermediaries (being both brokers and agents) shall not with intent to deceive make a false or misleading statement in relation to any amount that would be payable for a proposed contract of insurance or as to the effect of any of the provisions of that contract. This precludes inserting false information in a proposal or claim form. A misleading statement also includes reference to omitting to disclose information that is material to a statement.
 - 2) ***Section 11: Liability for Conduct of Agents & Employees.*** Section 11 of the Act states that the insurer is responsible for the acts of its agents, which includes acts such as completion of proposals and acts outside actual or apparent authority.

- **Insurance Contracts Act 1984.** This Act reiterates the need for contracts to be entered into in 'utmost good faith'. This requires, among other things, that the parties to the contract must communicate every fact and circumstance of which they know, which may influence the other to enter into the contract, or not. It applies equally to the insurer (life company and its agent) and the insured (the consumer). This is set out in sections 21 and 22 of the Act, detailing the insured's duty of disclosure and the need for the insurer to inform the insured of that duty.

The Insurance Contracts Act also deals with ambiguous questions that may be asked in relation to a proposed contract of insurance. Section 23 of the Act states that where a question appears ambiguous, the meaning shall be deemed to be the meaning put forward by the person making the statement. In other words, if a question is unclear and the consumer answers it in a certain way, that answer will be taken as the final answer to that question.

The Act also provides for the 14 day cooling off period in relation to policies issued. As well as saying what information the insurer (and its agents) must give to the consumer, the Act also says how the information is to be given.

- **Australian Securities and Investments Commission Act 1989 ("ASIC Act")**. Unlike the other Acts discussed above, the ASIC Act is not confined to insurance. Part II, Division II of the ASIC Act provides protection to consumers by prohibiting certain types of conduct in the provision of financial services. The main areas concern unconscionable conduct and misleading or deceptive conduct.

Code of Practice for Advising, Selling and Complaints Handling in the Life Insurance Industry ("Life Code")

The Life Code was issued in August 1995, to become effective from 1 January 1996. The Life Code was developed to:

- promote the provision of high quality advice in relation to life policies, so that where policies are issued they are appropriate to the needs of the persons to whom they are issued
- ensure that life companies and intermediaries maintain a minimum standard of service when dealing with customers in relation to life policies
- ensure that insurance advisers are competent in arranging the issue of life policies
- ensure that appropriate internal and external complaints procedures are in place.

The Life Code is the primary regulatory standard in relation to conduct and disclosure concerning the provision of advice (relating to life insurance products) to consumers. The Life Code was issued as an ISC Circular (Circular G.II.1) as an interim measure, with the view that it would be included in an amendment to

the Life Insurance Act (1995) in the early part of 1996.¹⁴ However, with the announcement of the Financial Service Inquiry in early 1996 the amendment was delayed. This has had the effect of the circular remaining the main consumer protection requirement in relation to advice for life insurance products, but without a legislative base.

In taking responsibility for the Life Code in 1998, ASIC has continued to encourage life companies to meet the requirements of the Code. Recent legislative reforms, including the FSRB have included a review of some of these consumer protection issues, and will be referred to in the context of this campaign.

Disability Insurance

Disability insurance is a catchall phrase used for the purpose of this report to describe policies which will grant a benefit in the event that the insured becomes disabled or suffers from a medical condition listed as a specified event in a policy.

The disability insurance types considered were as follows:

-
- **Total and Permanent Disability.** This policy will pay out a lump sum in the event that the insured becomes totally and permanently disabled, a term which again will be defined in the policy. Often both disability and total and permanent disability benefits are provided in one policy.
- **Trauma insurance.** This policy will pay out a lump sum in the event that the insured suffers a trauma covered under the policy. Major traumas include kidney failure, cancer, stroke, heart attack and coronary bypass¹⁵.
- **Income protection.** This policy will provide an income stream rather than a lump sum in the event that the insured meets the disability definition. The income stream is usually based on a percentage of salary, and is generally capped at 75 per cent of the gross salary earned.
- **Term Insurance.** Under this policy the sum insured is payable only if death occurs during a limited period of time, being the term of the policy. Term insurance contracts, which were considered in this campaign, contained disability contracts, which were issued as riders or additional benefits, which were incorporated into such life policies.
- **Business expense cover.** This policy provides reimbursement for on-going business expenses that are incurred during the benefit period (normally 12 months) in the event that the life insured is totally disabled. Usually a partial disability benefit and death benefit is included as well.

¹⁴ Circular G.II.1, page 2 (introduction).

¹⁵ Personal Investor, March 2000, page 88.

While term life has been a product in existence for some time, trauma and income protection insurance are products that have become increasingly popular over the last 15 years. However, there are increasing concerns in the industry as to the profitability of income protection products.

In a paper presented at the Investment and Financial Services Association ("IFSA") conference in July 1999, Michael Rice (Rice Kachor Research) stated that income protection was a 'product in crisis'. This has been due in some part to problems with product design, distribution (particularly commission rates) and significant claims. As a result, the premiums for this product have continued to rise through the year 2000. In the past two years, Rice Kachor Research estimates that income protection premiums have risen by between 10 to 15 per cent across the industry.¹⁶

Despite the fact that the product continues to be an important part of the personal risk insurance market, it has continued to make losses. APRA recently announced 'that it will take a closer look at the area of disability insurance after continued concern by the regulator over losses in that area.'¹⁷

¹⁶ Investor's Adviser, 14 February 2000, page 8

¹⁷ 'APRA to keep watch on insurance', Jason Spits, Money Manage Daily Web News, 13 September 2000

Section 3: Research Approach

This section discusses the methodology used to develop and undertake the campaign.

Overview

The purpose of the campaign was to review the systems and practices of life companies and their agents in relation to consumer protection compliance for life insurance disability products.

Consumer protection compliance refers to compliance with the Life Code and applicable life insurance legislation.

Disability products refer to the disability product class for life insurance products. It does not include general insurance accident and illness policies. For the purposes of this report, the surveillance was conducted on:

- Disability Income Insurance (also known as income protection insurance)
- Trauma Insurance (also known as dread disease Insurance, medical catastrophe or critical condition insurance)
- Total and permanent disablement rider (usually encountered as a rider to a yearly renewable term insurance).

Surveillance

In order to review the level of consumer protection compliance, an inspection was conducted on a number of life companies and their agents.

The life companies were selected taking into consideration:

- Disability products in the market
- Disability market share
- Agency structure (use of multi or sole agents)
- Issues identified during the ISC's Life Code review in 1996
- Complaints history.

The life companies selected hold a total of \$57.782 billion of assets, being 37% of total assets held by life companies in Australia. They have issued 11,150 agency agreements, being 25% of agencies held in 1999.

In relation to disability products, the companies hold \$237 million in-force annual premiums, or 42% of the market. They also wrote \$58.8 million in new annual disability premiums in 1999/2000, totalling 39% of the market.

Inspections on the life companies were conducted in May 2000. The inspections included on-site visit by ASIC officers, who asked a number of questions specifically relating to training, supervision and consumer protection compliance. Background documents relating to the above issues were also obtained from the

life companies for review prior to the visit. All but one life company provided the materials voluntarily. That life company requested that a notice for documents be issued pursuant to sections 11C and 11D of the *Life Insurance Act 1995*.

Life companies were also requested to provide details about the top, middle and bottom revenue writers of disability insurance in each State and Territory. This information was used to randomly select a number of agents to review, representing each life company that had been reviewed previously.

These reviews were conducted from July to September 2000. Reviews were conducted in every State and Territory. Prior to the agent reviews taking place, one life company agreed to participate in a pilot surveillance to test and review the approach undertaken.

A total of 59 agents were reviewed. The inspection portion of the review consisted of an on-site meeting, where the agent was asked a number of questions regarding training, supervision and consumer protection compliance.¹⁸ A random sample of files (approximately 4 to 6 files per agent) was then reviewed. For some agents, fewer files were selected where multi-agents wrote less work with particular life companies than was previously indicated in the information obtained from the life companies.

Both the life companies and life agents involved were generally aware of the campaign and responded well to the inspection requests.

¹⁸ Information obtained from the questionnaires used for both the life companies and life agents form the basis of the reports used to prepare this paper. The questionnaires are not available for public distribution and remain the intellectual property of ASIC.

Section 4: Findings

Overview

This section will break down the findings and observations into four parts:

- **Compliance and operating environment.** A review of the life companies' adherence to the Life Code and knowledge of the life agents of their consumer protection compliance obligations.
- **Supervision.** A review of the legislative and Life Code requirements of the life company for the supervision of life agents, and agents' observation on supervision needs.
- **Training.** A review of the requirements set out under the Life Code and issues concerning ASIC's interim policy statement on training of authorised representatives (IPS146) will also be considered.
- **Conduct.** A review of the advising and sales practices in relation to the Life Code and relevant legislative requirements.

1. Compliance and Operating Environment

Compliance Approach

In August 1995, the previous regulator, the ISC, advised all life companies that they were required to provide an implementation plan and interim compliance report in advance of the introduction of the Life Code. Both documents were to be returned to the ISC by 30 September 1995 and December 1995 respectively.¹⁹

In preparing for the review of the life companies prior to this campaign inspection, ASIC analysed the information received by the ISC and other material on file in relation to the adherence by the life companies to the Life Code.²⁰ The analysis was performed to ascertain what changes had been made since the introduction of the Life Code to the compliance and operating environment of life companies.

We generally found that the life companies had updated and modified their compliance structure to meet the requirements of the Life Code. Such changes included:

- creating a 'culture of compliance' by making business units responsible for specific compliance issues;
- standardisation of documentation issued to life agents. (the majority of life companies reviewed used documentation issued by or at MARG standard);
- standardisation of field audits conducted on life agents.

One life company had made some changes to its compliance system in response to issues of concern previously detected by the ISC. However, these changes were minimal when compared with the range of issues that the ISC had previously identified as being of concern.

An outstanding issue of note was that the life company continued to rely on a self-assessment system for compliance with paragraph 28 of the Life Code. This paragraph requires that a life company must ensure prior to an agent being given authority to provide advice to a client, that the agent has adequate knowledge on the requirements of the Code, legal obligations and procedural issues.

While the agent may certify that he or she meets the standard, ASIC does not believe that this self-certification results in the life company meeting its obligation to ensure that the agent can demonstrate the stated competencies, as required by paragraph 28 of the Life Code.

In summary however, a general improvement was noted in the compliance approach to the Life Code since its implementation in 1996. This is an important

¹⁹ Circular G.II.1 Explanatory Memorandum, paragraph 5.

²⁰ These files became the property of ASIC during the formation of ASIC and APRA from 1 July 1998.

development by life companies, as the Life Code is currently the basis of consumer protection in the life insurance industry. Further, it is important that life companies continue to support the principles of the Life Code, even though the Code has not been legislated as being compulsory under the current financial services regulatory regime.²¹

Compliance Committee

Of the life companies reviewed, all but one had Compliance Committees that were sub-committees of the full Board of Directors. One life company did not have a designated Compliance Committee. In that company, compliance is dealt with by the Audit Committee, which is also a sub-committee of the full Board. All the committees met at least quarterly, some with provisions for special meetings as required.

ASIC's view is that a designated Compliance Committee should report to the Board. This function should not be a part of the Audit Committee's role, given that the Compliance Committee should enable the Directors of the Board to acknowledge their consumer protection responsibilities. Paragraph 3 of the Life Code Explanatory Memorandum stated:

'The draft Consumer Protection Provisions under the Act require the establishment within each life company of a Compliance Committee. The principal purpose of this Committee being to assist in dealing with consumer-related issues that arise in the course of the life company's operations, and to ensure it to comply with Disclosure Rules and the Code of Practice. The motivation for establishing the Compliance Committee was to reinforce with life companies the importance of the Consumer Protection Provisions and to ensure that directors recognised the responsibility in respect of these matters was theirs.'

Further, ISC Circular G.II.2 (issued in November 1995) stated that:

'While the consumer protection provisions have not as yet been incorporated into the Life Insurance Act 1995, the ISC expects that as from 1 January 1996 each life company will either have established a fully operational Compliance Committee, or established procedures that ensure the functions of the Compliance Committee are undertaken by the Board of the life company ... The Compliance Committee must report to the Board of the life company concerned. Its members may either be directors of the life company or persons approved by the Commissioner.'

Accordingly, in keeping with principles of the consumer protection compliance provisions proposed under the Life Code, it is highly advisable that life

²¹ The conduct and training obligations may alter for the life insurance industry under the proposed FSRB reforms. This is discussed later in this paper.

companies without a designated Compliance Committee work immediately towards establishing such a Board Committee to review consumer protection and compliance issues.

In relation to the activities of the Compliance Committees reviewed, they generally dealt with issues raised through exception or management reporting, such as major regulatory problems and other significant matters, issues raised in external auditor reports and complaints summary reports. To that end, life companies appear to be meeting the reporting obligations set out at paragraph 43 of the Life Code:

'All serious or persistent conduct infringing this Code must be referred to the life company's Compliance Committee (or to the Board of the life company) ... so that systemic problems or problems with particular life insurance advisers can be identified and rectified.'

The ways in which the life companies recorded and reported infringements of the Life Code or regulatory breaches varied. They ranged from specific registers that noted risks, breaches and compliance failures to no documented procedures. Where no documented procedures existed, the life companies stated the head of compliance would deal with the issue.

Paragraph 44 of the Life Code requires that,

'Where a life company ... becomes aware of a material breach of this Code, it must check the appropriateness of the procedures applicable, and of the relevant policies previously issued through that life insurance adviser during the three year period preceding the date on which it became aware of the breach (on or after the date of the commencement of the Code) and take remedial action where appropriate.'

Despite this statement of specific actions required in paragraph 44, ASIC was concerned that the majority of the life companies reviewed did not have this policy incorporated into their approaches.

Compliance procedures

All life companies reviewed had compliance officers/managers with seniority within the company. The majority of the officers reported to the Chief Financial Officer (CFO) rather than through reporting lines linked with business operations. We believe it is important that the two lines of accountability remain separate within a financial entity.

Were an internal dispute between compliance and a sales or marketing unit to occur, the majority of companies stated that the compliance/legal view would prevail. In one instance however, a life company stated that the matter would go

to the managing director for resolution. We would encourage the continued autonomy of the compliance functions and processes in these circumstances.

Personnel

ASIC also noted the range of experience across the personnel involved in compliance management in the life companies. Given the importance of the compliance management position to ensuring consumer protection and regulatory compliance, suitably trained and qualified personnel are very important to organisational compliance success. Further, for the purposes of consistency and stability, the position should not be left vacant for lengthy periods of time. We note that in one instance the compliance manager's role was left vacant in a life company for over six months.

In terms of reporting lines, ASIC does note that best practice recommendation pursuant to the AS-3806 is, however, that the Chief Compliance Officer report to the Managing Director or Chief Executive rather than the Chief Financial Officer to give compliance appropriate status within the organization.

Information

The arrangements to provide compliance information to agents varied across the life companies. They ranged from on-line access compliance material to compliance procedures integrated in the operations manuals. However one life company had no compliance manual at all stating it did not have the resources to devote to preparing the document.

Documented Procedures

We regard documented compliance procedures as a critical element in providing adequate supervision of agents. The purpose of the compliance manual should be to inform agents of the standards set by the life company to perform their functions. This should take into account the law, regulations and best practice. Although this campaign was considering compliance with the Life Code, ASIC would expect as best practice that a compliance manual and supporting plan meet the standards set out in the Australian Standard for Compliance Programs (AS 3806-1998) ('the Compliance Standard').

According to the Compliance Standard, a compliance policy (or plan) needs to include a clear statement of the organisation's commitment to applicable laws, regulations, codes and organisational standards.²² In addition, a compliance program should also promote a culture of compliance in the organisation and assist the organisation in remaining or becoming a good corporate citizen.²³ Statements about the organisation's commitment to compliance need to be clear and convincing. Managements need to convey to staff and other relevant

²² Australian Standard Compliance Programs (AS 3806-1998), Standards Australia, Section 2.3.2, page 6.

²³ Ibid., Section 1.2, page 4.

stakeholders the clear message about their compliance commitment, and that lip service does not constitute compliance.²⁴

In addressing the issues set out in the Compliance Standard, a compliance plan should address the following:

- identification of compliance issues;
- operating procedures for compliance;
- implementation of such procedures;
- complaints handling procedures;
- methods to identify and rectify compliance failures, particularly systemic and recurring problems;
- internal reporting structures for reporting compliance issues;
- appropriate management supervision of compliance.²⁵

Accordingly, we believe that failure to produce and update compliance documentation is below the compliance standard accepted in the financial services industry, and the standard acceptable to ASIC. ASIC's view is that a compliance manual provided in either hard copy or electronically is highly recommended for the communication of compliance policies and procedures and regulatory or legislative changes.

The test for the effectiveness of the compliance documentation rests with the target audience – in this case, the agents. Generally, agents stated that the life companies stressed the need to adhere to compliance. However the following observations were noted:

- few multi-agents knew the name of the compliance officer of the life company under review. They were better acquainted with the external service provider(s) to the life companies who conducted audits on the agent on behalf of the life company;
- a number of multi-agents said they rarely had contact with the life company on compliance, except to send in the Customer Advice Records (CARs). One agent stated 'the level of attention paid to compliance issues versus product development and selling is negligible';
- one agent stated the life company did not have a compliance manual, when one was available both on paper and electronically. This highlighted a concern about audit procedures by the life company to ensure that all agents knew about and used the manual.

Compliance reviews

The majority of life companies under review used external compliance providers to conduct reviews of their agents' compliance with the Life Code. The frequency of the reviews conducted varies from two audits per year to once

²⁴ Australian Standard Compliance Programs (AS 3806-1998), Standards Australia, Section 3.2.1, page 8.

²⁵ Ibid.

every three years.

Life companies who primarily appoint sole agents tend to review their agents with more regularity than life companies who appoint multi-agents. This supports the observation noted in the ISC's last review of the Life Code, which stated,

*'Life Companies dealing with tied agents had a regular program of on-site inspection audits ... the life companies dealing with multi-agents, however, rarely attended the premises of agents other than as a marketing exercise to promote their own life products.'*²⁶

While it may be difficult for some companies to review their agents annually if they have appointed large numbers of multi-agents, one review every three years is not satisfactory, and is not comparable with current practices in the securities industry. Supporting this concern is ASIC's finding that some agents have been reviewed only once since the Code was introduced three and one-half years ago. In our view, best practice would require that reviews be conducted more regularly, particularly in relation to those selling high volumes of life company business.

Paragraph 43 of the Life Code requires that all 'serious or persistent conduct infringing the Code must be referred to the company's Compliance Committee or to the Board of the life company.' This requires documented procedures to ensure that serious matters detected in the compliance reviews are being appropriately referred. Given the strong reliance on external providers to detect any breaches that then must be reviewed by the life company for compliance purposes, we believe documented procedures for referral to Compliance Committees are critical.

While the life companies under review reported some detection and referral of Code breaches, several of the life companies did not have documented procedures for referral to the Compliance Committee. Generally, breaches were referred back to the business units for review and further action. One of the purposes behind establishment of a Compliance Committee of the Board is for the Committee to be fully apprised of the general compliance profile of the organisation. This would include being fully informed of the occurrence of material and/or continuing breaches of the Life Code.

Summary – Compliance and Operating Environment

The compliance structure and functionality is the base from which consumer protection operates. Failure to properly plan and resource compliance within an organisation can result in poor practices.

²⁶ ISC Ref no 96/1699, 'Report Card of Implementation of the Life Code of Practice', dated 23 October 1996, pages 7-8.

We generally found that the Life companies had updated and modified their compliance structure since the introduction of the Life Code. However, some work is still required to ensure that compliance issues are adequately documented and referred to appropriate areas of responsibility within the life company. Regular compliance reviews and accessible compliance standards are required to meet appropriate standards in consumer protection compliance.

2. Supervision of Agents

In reviewing the supervision of agents, we looked at life company reviews conducted on the agents themselves, remuneration, termination of agency agreements and complaints handling. The life company has obligations to adequately monitor agents and have complaints handling procedures pursuant to the Life Code; it also has regulatory obligations concerning appointment and termination of agents.

As previously noted in the compliance section of this report, the majority of life companies under review used external compliance providers to conduct reviews of the agent's compliance with the Life Code. The frequency of the reviews conducted varies from two audits per year to once every three years. Since this meant that some agents have been reviewed only once since the introduction of the Code, this issue was of paramount concern.

Remuneration

Methods of remuneration varied from commission to salaries. Agents of one company indicated that they could choose to charge fees instead of working for commission, but had not chosen the fee option. The majority of life companies paid agents by commission; some combined this with volume bonuses and volume commission rates.

Rice Kachor Research noted in February 2000 that 'in the early 1990's more multi-agents moved into the risk market because there was not, and still isn't any commission disclosure on risk-products.'²⁷

Paragraph 10(b) of the Life Code requires that at the earliest reasonable opportunity during advising and selling, a life insurance adviser must provide written advice to a customer of the means of remuneration of the life insurance adviser. This is normally set out in the disclosure of capacity document provided to the client. However, this disclosure document only states the method of payment (for example, commission), but not quantum.

The Financial Planning Association (FPA) states that as best practice, the quantum of payment should be disclosed to clients when advising on life insurance products. The FPA approach is as follows:

*'The FPA requires the same dollar commission disclosure [as per the Corporations Law in relation to securities] for risk insurance and other life products. The FPA requires that all recommendations for risk products such as term life, TPD, income replacement and trauma be made in writing and in \$.'*²⁸

²⁷ Id, FN 10.

²⁸ DFP8: Financial Plan Construction and Review (Semester 2, 1999), Deakin University and The Financial Planning Association of Australia Limited, page 5.24.

We observed that commission structures did not reward agents for providing their clients with full or limited advice, so that there was little incentive to provide advice on complex products such as disability policies. The Life company/agency relationship influences the commission structure, so that the emphasis is on life company products sold rather than advice given. Since it appears that the commission paid is the same however, irrespective of whether the adviser gives full, limited or no advice, a value for money issue for consumers of disability products arises.

Complaints

- **Internal complaints procedures**

We reviewed the internal complaints handling processes of the life companies and how life agents dealt with complaints. In the initial audit conducted on life companies (with the introduction of the Life Code) in 1995, life companies were asked to provide information on their internal complaints handling procedures. The life companies had made few modifications to the complaints process since that time, with the major change being a broader definition of what constitutes a complaint.

Part IV of the Life Code sets out the basis of complaints handling. It is prefaced with the statement that:

'All life companies and life brokers must handle inquiries in a timely manner, must have internal complaint-handling mechanisms which meet minimum standards and must ensure that complainants have access to effective and independent external and free dispute resolution mechanisms.'

It would appear that all life companies had structured internal complaints processes in place, and that they had been operating since the inception of the Life Code. However, one life company did not appear to have fully documented procedures about complaints handling, particularly in relation to dealing with agents who are repeatedly the subject of complaints. The agent's role in the process varied, but was primarily confined to providing information on the complaint and not dealing with the matter.

Knowledge by the agent of their role in the complaints process also varied. A number of agents said they were confused as to the difference between a complaint and an enquiry. Some life companies required all complaints to be referred to head office for resolution. Generally, agents of those companies were unable to answer questions on how the complaints process operated.

Paragraph 28(a) of the Life Code requires that agents be aware of complaints handling process, stating:

'Prior to the commencement of life insurance adviser registration, a life company or life broker must ensure that a life insurance adviser authorised on its behalf has adequate knowledge to enable him or her to demonstrate the following competencies ... the requirements of this Code, including complaints handling mechanisms'.

Accordingly, we would expect life agents to have a working knowledge of the complaints handling mechanisms. This would include the operation of the internal (life company) complaints process, together with the ability to access external complaints handling. Greater compliance on this issue is required.

- **Subject of complaint**

Where disability insurance was one of a suite of products sold by the life company, the life companies said the disability component only constituted a small percentage of complaints. Where disability insurance was the product in dispute, the main issues appeared to be a misunderstanding of the product and claims issues.

The number of complaints concerning disability products as advised to APRA has been consistent over the past two years. The top six life insurance companies in disability insurance represent 87% of the complaints received. The majority of complaints concern income protection and trauma policies.

The number of disability insurance complaints reported to the external dispute resolution scheme for life insurance companies, the Financial Institutions Complaints Service (FICS - previously LICS) increased from 31% of total complaints received in 1997 to 43% of complaints received in 1998. FICS also recorded income protection insurance as the highest area of complaints overall, as well as being the area from which most determinations issued by FICS during 1999. We reviewed the determinations issued by FICS from August to December 1999 and noted the majority of matters concerning disability insurance primarily related to poor understanding of product and claims. This is consistent with the issues raised by life insurance companies in their internal complaints handling procedures.

The consistency of this result across both internal and external complaints schemes suggests that agents are not adequately explaining key elements of the cover to clients.

During this review, ASIC sought to test the role of the agent by asking them to explain the definition of total and permanent disability in relation to the disability product under review. Agents were also asked about their knowledge of the claims process.

The agents interviewed during this campaign did not always adequately explain the definition of total and permanent disability. In relation to multi-

agents, often no distinctions were made between the TPD definitions contained in the policies of different life companies, even though the products were sometimes quite dissimilar. In some cases the diversity of disability products offered by one life company alone led to differing results on this question. Because disability insurance products are typically difficult to understand - and coverage can vary between products – we are concerned that consumers may not be fully aware of the differences between available policies in the absence of advice.

The agents of two life insurance companies consistently indicated that the Life Company provided them with very little, or no, information about the claims process. Some agents said that they acquired knowledge about the process through their involvement in individual claims (and the answers given by several of these agents demonstrated such knowledge). Other agents pointed out that they are not involved in the claims process and did not demonstrate any knowledge of the process. In the main, agent involvement in the process if any, centred on assisting their client in obtaining and completing a claim form. It was not surprising to learn therefore, that such agents had no knowledge of, or feedback from the life insurance company about issues arising in disputed claims.

Training on claims handling

The issue of providing information on the claims process is of concern, as paragraph 29(d) of the Life Code requires that:

'A life company ... must ensure that a life insurance adviser receives sufficient information and/or training to enable him or her to satisfy the following competencies for each specific company product that the life insurance adviser has been authorised to sell on its behalf ... and adequate knowledge of the life company's systems, forms and procedures for that product, including procedures in the case of a claim or termination.'

Given this obligation, ASIC Interim Policy Statement 146 (IPS 146) should be considered as the standard by which the level of agents' knowledge is measured by the life companies. IPS146.131 states the following skill requirements are appropriate subject matter for training by the life company on

- claims handling;
- explaining the process of claims lodgment;
- explaining complaints resolution procedures, communicating clearly with consumers and acting fairly in all the circumstances;
- conducting the process in accordance with the principals' policies and procedures.²⁹

²⁹ Issues concerning training are generally discussed in the next section.

An agent as representative of a life insurance company, with the authority to sell a product such as disability insurance, should have a general understanding of what should occur in the event that a claim is made on the policy. After all, the purpose of taking out such a policy is the ability to claim on that policy should a specific event occur.

We believe that agents should have requisite knowledge of claims management and be able to communicate that knowledge to their clients as necessary. Further, such information should be made available to clients during the process of advising on the product so that the client can consider the claims process in determining whether or not to proceed with the insurance. ASIC is concerned that there is non-compliance with this element of the Life Code and that non-compliance should be rectified as soon as possible.

As a recent "Consumer Directions" article on income protection insurance points out:

*'Always remember it is at the time of claim that you will realize how good your policy is, how good your agent is and how good the insurer is.'*³⁰

Accountability for agent conduct

Paragraph 44 of the Life Code requires that where a life company becomes aware of a material breach of the Code it must check procedures and policies and take remedial action where appropriate. In addition, section 11 of the Insurance (Agents and Brokers) Act 1984 states that the insurer is responsible for the conduct of the agent (in relation to any matter relating to insurance), whether or not the agent acted within the scope of their authority.

Given the obligation on the life company in relation to a 'material' breach, we asked the life companies reviewed for examples that would warrant remedial action. The life company responses to this question included the following:

- misleading and deceptive conduct
- fraud
- lack of co-operation in complaints resolution process
- failure to properly explain the reason for selling a product
- non-disclosure
- repeated failure to rectify non-material breaches within set timetables.

We would expect each life company to communicate to its agents what the company would regard as a material breach, so that an agent would also be fully aware of his or her obligations to the life company and under the Life Code. Whilst all life companies were able to provide a verbal response on this issue, most life companies did not have a documented policy.

³⁰ Consumer Directions, September 2000, page 14.

Several companies did cite repeated failure to rectify non-material breaches and systemic problems as the basis of a material breach. Systemic problems are generally based on analysis of compliance reviews, together with reviews of complaints registers and trend analysis documents. All companies reviewed had a process in place to identify systemic issues, which we believe is necessary in order to meet the monitoring and supervision requirement under paragraph 40 of the Life Code. However, none of the companies reviewed integrated issues arising out of complaints back into training its agents.

Termination of agents

As there are legal and Code obligations which make agents accountable to life companies for their actions, we sought information from life companies as to what steps they would take when terminating an agent generally, and terminating an agent where a breach of the Code occurred. The process varied across the life companies – some companies had formal procedures whereas others operated on a case-by-case basis.

Generally, life companies reviewed the terminated agent's files and other work to analyse and rectify any problems that may have occurred. If the agent terminated was a multi-agent they would contact other life companies to ensure that the agent has advised the other life companies of that termination, as is required by legislation.

Given the obligations of the life companies in terminating agents – particularly where a breach is involved, we would expect as best practice that policies and procedures be in place establishing the process of termination and notification. We would also expect that as a matter of good business practice that such policies would be documented as part of the agency agreement.

In cases where an agent is dismissed for suspected or actual misconduct, we believe the life company should undertake the following actions:

- Review the agent's files to see if the misconduct leading to the termination was an isolated case or occurred in relation to a number of transactions or clients;
- Proactively identify other consumers that may be affected by the behaviour of the agent;
- Review pre-appointment vetting procedures to determine if referee checks and all other procedures were followed;
- If the agent terminated was a multi-agent contact other life companies to ensure that the agent has advised the other life companies of that termination. (Section 33A(5) of the Insurance (Agents and Brokers) Act 1984 requires that an agent is obliged to give written notice to all its principals within seven days of termination or expiry of an agency agreement.)

Summary – Supervision

There is a Life Code obligation for life companies to supervise the conduct of their agents. There is a need for full documentation of policies and procedures in this area, so that the expectation of life companies and the obligations of the agents are known and understood.

3. Training

Part III of the Life Code (paragraphs 28 to 31) specifies the requirements of life companies regarding the training and competency of life insurance advisers.

The requirements are:

- that agents must demonstrate basic competencies concerning knowledge of the key elements and procedures of the Life Code;
- that agents must be trained on product-specific competencies;
- continuing education to meet competency requirements.

In addition, IPS146 gives guidance to life insurance companies on how they can meet their obligations to ensure that their agents providing financial services to retail consumers have undertaken education and training that meet ASIC's requirements for knowledge, skills, integrity and continuing education (IPS 146.1). IPS 146 recognizes the obligations for training under the Life Code (IPS 146.11).

To meet the requirements outlined in IPS 146, paragraph 146.15 indicates that life companies will need to take the following steps:

- identify the tasks and functions that their representatives perform;
- determine the appropriate ASIC knowledge, skills and integrity requirements ;
- ensure that their training programs or individual agents are assessed by an authorised assessor;
- implement procedures for continuing education of the agents.

We reviewed the training provided by life companies to agents in relation to both basic competencies and product-specific competencies, with an emphasis on disability insurance.

The majority of training across the life companies was in relation to product training. Disability product training varied across the life companies, depending on the importance of the product in the suite of insurance products on offer. However, across the life companies reviewed it was a product for which significant training was given. Life companies generally stated that training on disability products was ongoing.

However one stated it would notify agents by newsletter from the marketing department if there were any changes to the product. Given the requirement under the Life Code and IPS146 for continuing training of agents – and that product training is clearly a significant part of that training – we would expect a documented strategy by life companies for ongoing training on products.

One life company asked agents to complete a training and competency questionnaire prior to starting as an agent of the life company. The questionnaire asked that the agent advise whether or not they meet the basic competencies listed under paragraph 28 of the Life Code. All agents of this life company have ticked 'yes'. This life company accepted those answers at face value and has given no training on basic competencies on the Life Code. ASIC does not believe that this satisfies the requirement of paragraph 28 of the Life Code, nor does it adequately address the procedure set out under IPS146.15.

Two life companies reviewed had a strong emphasis on skills based competencies, particularly in relation to the Life Code requirements of CARs and fact finds. Generally, compliance training was minimal, with few life companies providing training on consumer protection requirements.

IPS146.56 states that principals will have to judge the range and depth of knowledge and skills their representatives should possess to carry out the particular activities required of them. We have noted the complexity of disability insurance, the number of complaints (primarily on interpretation issues), and the consequences for consumers who are not covered in circumstances where they may believe they have coverage.

Due to the complex nature of this product, ASIC believes that the requirements for the proposed Tier 1 training under IPS146.72 should be met. Apart from the issues listed above, we believe that the nature of the product and its coverage consequences are such that it does not entail a low level of risk for the consumer, and therefore training at a higher level should be given.

IPS146.72 sets out a number of requirements concerning analysis, knowledge and judgment skills to be taught. As the majority of training that life companies conduct for their agents currently appears to be in relation to product matters, we believe that life companies should review their current strategies to fulfill meeting the basic competencies set out in paragraph 28 of the Life Code and the standards set out in IPS146.72.

The method of delivery of the training by the life companies included in-house workshops, developmental seminars and/or presentation by external presenters and electronic examinations. Pass marks range from 80 to 100%. In all cases, representatives can re-sit the examination if they fail to attain the pass mark. Examinations are a mixture of open book, multiple answer and closed book.

Agents provided some critical comments about the testing (assessment) systems. For example, some said that:

- tests were very easy to pass; and
- agents could get others to answer their test questions.

The lack of compliance training was evident when agents answered questions about their knowledge of the Life Code. Generally, knowledge was poor across the agents reviewed. One example was in relation to the main obligations of an agent under the Life Code, where some answers included:

- *'Advisory Services Guide to be provided to all potential clients'*
- *'The first objective is to sell some protection. The second is the obligation to recommend the right product for the right need. Thirdly is the price, which invariably determines the amount and type of cover.'*
- *'To identify yourself properly.'*

Agents also commented that the majority of training they received was product focused, and tended to be provided when a new product was launched. Despite the fact that most life companies said the training was continuous, agents were critical of the frequency of training. Many agents said they had not received training on disability products 'in recent years', many citing at least two years since the last formal training. Several agents stated they received 'product updates.'

While the emphasis on Life Code requirements in training varied, most agents stated that the training they received in this area was minimal. Remote agents in particular appeared to have difficulties attending training due to cost, time and the fact that they cannot leave their offices unattended.

Poor knowledge of the Life Code was also reflected in the inconsistent and incorrect warnings given to clients in relation to 'limited advice' and 'no advice' sales. A considerable number of agents appeared to have difficulty differentiating between the two. One agent stated she had only had two 'no advice' sales. However, of six files randomly selected for review, three were 'no advice' sales.

Summary – Training

ASIC would expect a strategy developed by life companies that clearly sets out how the requirements of the Life Code and IPS146 will be met, particularly given the importance of determining the knowledge, skill and integrity requirements associated with the nature of the product on which advice is being given.

Although IPS146 is not a mandatory requirement until 1 July 2002 for life companies, we would expect that the training requirements for claims handling would be currently incorporated into product specific competencies to meet the Life Code requirements.

Concerns about whether the industry will meet ASIC standards have also been expressed recently by industry participants such as John Prowse, General Manager, IntegraTec who said:

'We're not saying that it's (IPS146) compulsory but that they should do

something now.' Prowse agrees that all those affected by IPS146 must develop a sense of urgency. *'From what I've seen institutions range from being prepared for IPS146 to not prepared at all,' he says. 'There's lots of work to do and if they put it off much longer they'll have great difficulty meeting the deadline.'*³¹

ASIC would also recommend that life companies implement an assessment strategy that truly reflects the agents' knowledge and engage in remedial training if agents are unable or unwilling to demonstrate Life Code, product and claims handling knowledge to an acceptable level.

³¹ Money Management, September 14, 2000, page 18.

4. Conduct Issues - Life Code

The Life Code applies to life policies, as defined under the *Life Insurance Act 1995*. We sought external advice on the actual application of the Life Code by industry. We were advised that as a matter of practice, life insurance companies have treated the Life Code, since its inception, as applying to the advising and selling practices of their advisers in relation to all of their products. To that end, we have considered the knowledge and conduct of both life companies and agents across all disability products reviewed, even though two products arguably did not strictly meet the definition of 'continuous disability product' under section 9A of the Life Insurance Act 1995.

In this section we reviewed the development and use of the key documents under the Life Code; namely the disclosure of capacity, fact finder, needs analysis, and Customer Activity Record (CAR). Issues concerning the legislative duty of disclosure are also discussed.

Disclosure of Capacity

Paragraph 10 of the Life Code requires that the agent provides to the client, at the earliest opportunity during advising or selling, written advice on the details of the agent, means of remuneration, who is responsible for the adviser's conduct, and extent of products on which he or she can advise. This information is provided in a "disclosure of capacity" document, which is either provided separately to the client or detached from the fact finder/CAR documentation. The purpose of this document is to clearly inform the client of issues concerning the agent and who is accountable for the advice.

The life companies reviewed that engage tied agents use a pro forma set of standards in developing the disclosure of capacity document, which must be used by their agents. Agents are not permitted to develop their own forms, although one company has permitted a disclosure document to be reproduced in Vietnamese.

The life companies reviewed set general requirements for disclosure of capacity. Where multi-agents were involved, they allowed those agents to develop their own forms. All but one life company stated the forms must be referred to the life company prior to use. Once the documents are in use, the life companies test them in a variety of ways, including:

- as a best practice measure, encouraging clients to sign the CAR, which confirms information about the disclosure of capacity,
- random sampling,
- review during compliance audits,
- periodic customer surveys.

One life company stated that agents set their own standards and that the company did not review those standards, nor pre-vet the documents. The lack of

vetting of such documents is a concern, particularly as to whether this extends to other media, eg. supervision of website information. The life company also does not provide any advice to their agents as to the appropriate format or content of the forms. The standards and use of the documents are reviewed when the external compliance reviews are undertaken.

The disclosure of capacity is an important document. It provides the client with information about the agent to make an informed decision as to whether the agent can provide the range of advice and products the client may be seeking. Given the importance of this document as a consumer information tool, ASIC would expect that life companies would have standards in place as to content and effective systems to test the documents, and to vet documentation prior to its use. We would also encourage proactive use of testing the effectiveness of the documents with both agents and clients, such as random sampling, mystery shopping and customer surveys.

ASIC also has concerns about merely relying on the post vetting disclosure of capacity documents, as it appears that such documents were provided to clients by some agents, but not by others. We also noted that some life companies reviewed had the disclosure document as part of the CAR. Accordingly, agents may not provide the disclosure of capacity document to the client until the CAR is completed. This does not meet the requirement of paragraph 10 of the Life Code, which requires the information 'at the earliest reasonable opportunity.'

Fact Finder and Need Analysis

Paragraphs 12 to 16 of the Life Code set out the obligations concerning a fact finder and need analysis. They are designed to ensure that clients are provided with appropriate advice in relation to life insurance.

The process of setting standards, development and vetting the fact finder was consistent across the life companies reviewed, and comparable with the processes regarding the disclosure of capacity document, and also the CAR (discussed in the next section). One life company does not vet or approve the fact finder or needs analysis itself, but requires that the agent tick a box on checklist documents submitted to the life company that the fact finder and needs analysis are completed correctly. We do not believe this approach fulfils the obligation of the life company to demonstrate compliance with the Life Code pursuant to paragraph 40.

CAR

The CAR is the primary document provided to the client, which provides an explanation of the adviser's status and obligations, and clearly explains the basis of the advice.

Generally the life companies reviewed have not substantially altered CARs in the last twelve months. Most life companies retain copies of the CARs by scanning the document and storing the originals. The documents are generally vetted by the life companies to ensure they are completed, however one company relied solely on the external audit process.

The critical issue is to ensure that the client is receiving advice that is reasonable and appropriate. The majority of life companies reviewed stated that they tested the reasonableness of advice through compliance reviews, while others have a random audit program.

While compliance reviews are certainly useful, we believe as a best practice measure that other processes should be in place to ensure the advice is appropriate. This would include a broader use by the life companies of random samples, or CARs, analysis of systemic trends (including nature of advice and demographics of client), and development of other 'alarm bells' that would trigger a review shortly after documentation is provided. Given that the reviews may be conducted one to three years after the advice is provided, reliance on external audit reviews may be too little, too late.

Further, the advice should be communicated in a way that is easily understood by the client. Most life companies indicated that they tried to achieve this by ensuring that their Customer Information Brochures (CIBs) were written in plain English, which should assist the client to better understand. However, the CIB explains the product – it does not explain advice. Other responses regarding communication of advice included:

- translation of documents for non English speaking backgrounds,
- training,
- instituting best practices in agents encouraging clients to sign the CAR
- the 14 day 'free look' period (though this is not directly related to the advice issue)
- life company reliance on the adviser's experience.

To consider the presentation and quality of advice provided to clients, we reviewed approximately four to six client files of each agent interviewed, with some exceptions. The files were chosen at random by ASIC, and reviewed in relation to the requirements set out in the Life Code.

ASIC is concerned with the poor level of file information contained on agent client files. A considerable number of files reviewed did not contain copies of fact finders, needs analysis or CARs. In reviewing such files, we were generally

unable to form a view as to whether or not sufficient information about the client had been collected to provide a reasonable basis for advice. Nor was it possible to assess what analysis or research of alternative products (from the products they were authorised to sell) such agents had undertaken.

Whilst there were some agents who used complete fact finders, there was still a significant portion of agents who advised that they only used part of their fact finder or never used them at all. CARs were generally unsigned by the customer, even where it was the explicit policy preference of the life company to only accept signed CARs as part of their compliance procedures.

As a number of life companies rely heavily on compliance reviews to determine whether the agent is complying with the Life Code and providing adequate advice, we are concerned with the lack of information available on the file. We found that due to the paucity of information in many cases, we could not adequately discern if the client's needs had been met. We would also question how, in many cases, an agent would be able to refer to their file in the event of a complaint to ascertain what had actually taken place. (The auditing of such files would invariably be a very difficult process).

This is particularly of concern given that the vast majority of advice provided in relation to disability insurance was reported to be limited or no advice. In these circumstances, warnings must be clearly communicated to the client. While the warnings are generally stated on the CAR, given the low number of CARs that were signed and lack of file notes advising what transpired in the interview, we are unclear as to whether such warnings are being adequately communicated.

In relation to the client file documentation, we would expect the following as best practice:

- sufficient documentation on file to enable any independent auditor to determine the analysis and basis of advice
- where advice is limited or no advice is given, that an agreement to that effect is signed by the client. This must be contained in the CAR (paragraph 16 of the Life Code).
- customer objectives are clearly shown
- analysis of customer needs and particular product is shown
- where areas of documentation are not relevant for the particular client that a notation be inserted, rather than being left blank in the fact finder
- any limitation on advice is fully disclosed in the documentation particular to the client
- where advice is being provided on a replacement policy that a copy of the previous policy be placed on file (Paragraph 24 of the Life Code).
- full notation of discussion with client on relevant issues
- copies of calculations and quotes on file, particularly when determining level of cover

Duty of Disclosure

Section 21 of the Insurance Contracts Act requires that the client (the insured) disclose every matter of which he or she knows, that would be relevant to the contract of insurance. It is known as the duty of disclosure, and it lasts until the insured has entered into a contract with the insurer. Under the duty of disclosure, the client is not required to provide information that diminishes the risk, that is of common knowledge or that the insurer should have known. The duty of disclosure is an important obligation on the client, as failure to provide relevant information may invalidate the policy.

All life companies stated that the need for clients to disclose relevant information is explained in the application form or CIB. Responses varied from agents as to whether they informed clients of their duty to disclose. Some agents were unsure what the duty of disclosure was until explained to them by the ASIC interviewer; others stated they did advise clients when giving advice.

Given the importance of this issue to clients, we would expect as best practice that the duty of disclosure be highlighted to clients when providing advice, together with the implications of failure to adequately disclose.

Summary – Conduct Issues – Life Code

Documentation for Life Code obligations is generally prescribed by life companies, however a more prescriptive regime appears to operate with tied agents when compared to the multi-agents. The lack of systematic vetting of certain documents by some life companies is a concern, particularly in relation to the disclosure of capacity document.

Of greatest concern was the frequent lack of information in the agents' client files. It was difficult to determine whether advice was reasonable or even adequate given the lack of information on some agents' files. We also could not determine whether agents were effectively warning consumers about the risks associated with buying a policy without advice, or without the provision of adequate information by the consumer. Such problems should be apparent upon external review of such files by the life companies or their external service providers.

5. FOLLOW UP ACTION

The purpose of the surveillance was to review consumer protection compliance by life companies and agents in relation to disability insurance products.

We did not find uniform compliance on the following issues, which we believe to be integral to consumer protection compliance:

- all obligations stated under the Life Code met;
- documented compliance strategy for assessment of consumer protection compliance, updated regularly;
- dedicated Compliance Committees of the Board of Directors;
- compliance reviews conducted at least annually, with documented follow-up procedures, including referral to the compliance committee;
- appropriate disclosure of means of remuneration;
- documented procedures for analysis of systemic breaches as set out in paragraph 40 of the Life Code;
- documented procedures for termination of agents in relation to consumer protection compliance breaches;
- documented procedures for actions taken by life company where an agent is dismissed for suspected or actual misconduct;
- sufficient training on consumer protection issues (specifically limited and no advice) and claims handling;
- documented training strategy for production and delivery of training, as opposed to ad hoc training triggered by events (such as regulatory change or the launch of a new product);
- documented procedures concerning the production of documentation used to collect client information, conduct analysis, and provide information to the client;
- documented standards for material to be retained on file that would enable any independent auditor to determine the analysis and basis of advice;

In addition to current requirements and in advance of potential FSRB licensing implementation, life insurance companies should also be actively moving towards implementation of the following:

- broader training and skills development provided to agents in accordance with IPS146;
- compliance procedures and standards in relation to consumer protection that meet the Australian Standard for Compliance Programs (AS 3806-1998)

While the Life Code provides the current standard of conduct, proposed changes under the draft Financial Sector Reform Bill ("FSRB") will require a number of these issues to be considered in relation to the new single licensing regime. While the draft Bill has been deferred, it does have potentially significant compliance implications for the life insurance industry. The draft FSRB will essentially require that the client's needs and objectives be considered prior to making an appropriate recommendation in relation to life insurance products. A Financial Services Guide (FSG) will need to be issued to clearly show the client the capacity in which the adviser is acting, and a Statement of Advice will need to be issued to record and explain to the client the basis of a recommendation. Greater disclosure of fees and commissions will be required, in alignment with the current FPA standard.

Life companies will need to be licensed. Licensees will be required to ensure that their representatives are adequately trained and competent to provide the financial services pursuant to the licence. In addition, licensees must have internal and external complaint resolution procedures approved by ASIC.

In effect, the basic tenet of the Life Code will be absorbed into the FSRB. The thrust of the Life Code will become a legislative and licence requirement.

While the need for compliance with adequate consumer protection standards is required generally in the insurance industry, the emphasis of this surveillance was in relation to disability insurance. Given the number of limited advice and no advice situations reported in the context of this campaign, consumer protection compliance is especially relevant. This includes adequate warnings, documentation and audit procedures. Full compliance with the Life Code in these areas was not recorded.

Accordingly, while consumer protection compliance has not deteriorated since the last ISC audit in 1996, based upon the sampled companies and advisers we do not believe it has substantially improved. Few modifications have been made to procedures or documentation over time, with deficiencies noted in relation to both life companies and agents.

What we are doing now

As a first step, ASIC is currently in contact with each of the life companies that participated in the review. ASIC has advised or will be advising life companies about consumer protection compliance and specific Life Code deficiencies identified during the surveillance. ASIC will also monitor and request reports from life companies about any action taken to remedy deficiencies identified.

Some of the issues that are being raised with participating life companies include the following:

- ❑ compliance structure, documentation and reporting procedures
- ❑ review of agents
- ❑ commission structures and disclosure
- ❑ complaints and claims handling
- ❑ compliance training
- ❑ disability product knowledge
- ❑ file documentation
- ❑ use of client warnings

Our recommendations – what should happen next

We believe that consumer protection compliance issues as identified in this report must now be incorporated into the conduct, advisory and selling practices of the agents and the training and supervision procedures of the life companies.

On this basis, we propose the following:

1. We will actively review both the life companies that participated in this review and others to ensure that best practices standards in consumer protection compliance, to be developed in conjunction with industry, are being met.
2. ASIC will publish a consumer brochure to help people buying disability insurance cover. We will also seek industry assistance to clarify and improve policy terminology and disclosure about disability insurance.
3. Training and supervision of agents appear to be deficient in a number of key areas. ASIC has announced³² that life companies have until 30 June 2002 to comply with requirements on the training and supervision of agents as set out in IPS 146. ASIC has also said that it will seek information from all life principals in the second half of 2001 to assess their readiness to meet the

³² Media release issued 16 August 2000

deadline. We recommend that all life companies focus on developing strategies that set out how the requirements of IPS 146 will be met.

4. ASIC will, as part of its system of quarterly National Compliance Roundtables address these issues in conjunction with industry and will suggest best practice standards in advance of FSRB implementation. Specifically, the Compliance Roundtable will address: procedures for terminating agency agreements, compliance standards and agent record-keeping practices.
5. ASIC will request the Financial Industry Complaints Service (FICS), the Superannuation Complaints Tribunal (SCT), and Insurance Enquiries and Complaints (IEC) to assess complaints handling practices in relation to disability insurance. In particular we will ask these organizations to highlight any systemic issues that may be generating consumer complaints.