



Trade Practices Commission

**Life insurance
and
superannuation**



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Preface



During his opening address to the 1992 Annual National Convention of the Australian Lifewriters' Association in Launceston on 23 February the Minister for Justice and Consumer Affairs, Senator Michael Tate, announced that the Trade Practices Commission (TPC) would conduct a comprehensive program of research into consumers' experiences with life insurance and superannuation agents.

On 2 March 1992 Senator Tate directed the TPC in connection with the performance of its functions under paragraph 28(1)(c) of the *Trade Practices Act 1974*, to conduct research in relation to:

- (a) the means by which consumers identify and select life insurance and superannuation advisers;
- (b) the availability to consumers of impartial financial advice in relation to life insurance (including savings plans) and personal superannuation services;
- (c) the extent to which consumers:
 - ◆ are provided with accurate, objective and comprehensible life insurance and personal superannuation advice and product information; and
 - ◆ are made aware of the specific life insurance company or companies represented by individual life insurance agents and the nature of a life agent's legal responsibilities in this regard,and the extent to which current levels of disclosure may affect information and advice or contribute to unfair or anti-competitive conduct;
- (d) whether existing regulation is adequate to ensure fair and competitive conduct by life insurance agents;
- (e) the causes and effects of early termination by consumers of life insurance products and suspension of contributions to personal superannuation policies; and
- (f) the suitability and availability of remedies, other than those available through the Life Insurance Review Panel, for consumers subject to unfair practices of life insurance agents in relation to life insurance and personal superannuation policies.

The Minister asked the TPC to submit its report and recommendations by 30 November 1992. Senator Tate's successor as Minister for Consumer Affairs, Ms Jeannette McHugh indicated that she would be pleased to receive the report up until 17 December, the last sitting day of the current Parliamentary session. The full text of the Ministerial Direction and the associated media release are included at Appendix A of this report.

This report presents the findings of the TPC.

Executive summary



This is the report of the TPC to the Minister for Consumer Affairs in response to the Ministerial Direction of 2 March 1992 that it conduct empirical research into consumers' experiences with life insurance and superannuation agents.

The TPC has consulted widely with industry, consumers and Government departments and agencies. Representatives of these sectors were on the research project's Reference Committee, were consulted at all stages of the project, and were invited to comment on a draft of this report. The TPC has taken the views of the members of the reference committee into account in drafting this report but has not necessarily accepted them in arriving at its own conclusions.

Since the commencement of the TPC's research, the Life Insurance Federation of Australia (LIFA) and the Insurance and Superannuation Commission (ISC) have announced plans and proposals to address the major issues identified by the TPC. The TPC welcomes the proposed initiatives which are mainly directed at the areas of disclosure, regulation of agents, amendments to the life insurance legislation and consumer redress. While there is substantial agreement among the various interest groups about the nature of the reforms needed, it will be essential to specify the details of those reforms very clearly and to set in place regulatory and industry arrangements to ensure effective implementation and compliance. This report should provide a basis for assessment of these aspects.

The TPC research program drew on four main sources of information:

- ◆ consumer opinion surveys and related analysis;
- ◆ qualitative assessment of the accuracy, objectivity and comprehensibility of documentation and written and oral information provided to consumers;
- ◆ a large number of submissions from consumers, community and interest groups; and
- ◆ data and information provided by insurance companies.

Following is a summary of the TPC's response to each of the broad issues raised in the Ministerial Direction.

The means by which consumers identify and select life insurance and superannuation advisers

Referrals from existing clients and the regular review of existing clients' needs have a higher potential for selling new policies than a 'cold call' approach. The results of the TPC's consumer surveys are consistent with this view. The surveys showed that:

- ◆ 67% of recent purchasers knew the agent prior to this transaction;
- ◆ 32% selected the agent/adviser on the basis of suggestions from friends, family or work contacts;
- ◆ 26% made the selection on the basis of a previous business relationship.

The availability to consumers of impartial financial advice in relation to life insurance (including saving plans) and personal superannuation services and the extent to which consumers are made aware of the specific life insurance companies represented by individual life insurance agents and the nature of a life agent's legal responsibilities in this regard.

The TPC is concerned that life insurance agents may not be seen as providing impartial advice because they:

- ◆ have at law a primary fiduciary responsibility to one or more life offices rather than to the consumer they advise;
- ◆ have a direct financial interest in the sales transaction which may influence their advice; and
- ◆ are able to advise on only a limited range of products.

The consumer opinion survey results suggest that an unacceptably high proportion of consumers are unaware of these factors and believe that they are receiving advice from a person acting entirely in their interests when this may not be the case.

The extent to which consumers are provided with accurate, objective and comprehensible life insurance and personal superannuation advice and product information; and the extent to which current levels of disclosure may affect information and advice or contribute to unfair or anti-competitive conduct.

The consumer opinion surveys indicated that consumers rely heavily on the oral advice given by agents/advisers (68% used oral information from agents in reaching their decisions and 42% thought this was the most useful source of information). The TPC was not able to conduct surveys done that would allow an assessment to be made of the quality of the oral advice given. However, the surveys indicated that the provision of key product information was largely at the discretion of the agent with consumers not knowing what critical information to seek. Submissions from consumers contained complaints that key terms were not explained or that they were misinformed about the nature of the policy or the consequences of early termination.

The TPC commissioned an assessment of the written information provided to consumers. This concluded that documentary information is complex, key information is very difficult to find and there is no consistency between companies in their approach to information disclosure. It is therefore difficult for consumers to evaluate individual products and virtually impossible for them to do any comparison shopping prior to purchasing a life or superannuation product. This problem is likely to negate the benefits of the 'free look' period.

Whether existing regulation is adequate to ensure fair and competitive conduct by life insurance agents

As a result of consumers' information disadvantages in this market, there is considerable scope for unfair practices by some agents. Moreover the competition between them can have the effect of bidding up charges and commissions, rather than lowering charges and improving the quality of the product choices available to consumers. The existing regulations do not address these problems effectively and insurers have not controlled the conduct of their agents or implemented steps to stop 'bad' agents being recycled from company to company.

The causes and effects of early termination by consumers of life insurance products and suspension of contributions to personal superannuation policies

The consumer survey results showed that consumers discontinued life insurance and superannuation products because they needed the money (43%), felt that they were receiving poor returns (27%), had experienced a change in employment (9%) or were rearranging their finances (9%). One of the TPC's consultants has assessed that, overall, 36% of these consumers made a loss on their investment as a result of the discontinuance. However, this varied according to product category — from 23% for those discontinuing single premium superannuation policies to 63% for those discontinuing regular premium superannuation products.

The underlying cause of these losses is the way life offices attribute (front-end load) expenses to new business and recover these expenses when policies are discontinued. Data on discontinuances obtained from a representative group of life offices suggest that 50% of ordinary savings policyholders are likely to discontinue their policies by the sixth year and incur a loss on their investment/savings. Life offices take into account the anticipated discontinuance rate on a product when calculating their initial costing.

Available data suggests that an unacceptably high proportion of policyholders is incurring losses as a result of the front-loading charge structure used by life offices.

The suitability and availability of remedies, other than those available through the Life Insurance Review Panel, for consumers subject to unfair practices of life insurance agents in relation to life insurance and personal superannuation policies

The consumer surveys indicated that consumers mainly complain to their agent or insurance company but the majority (77%) of those that do are dissatisfied with the outcome. Very few of those surveyed complained to a Consumer Affairs Bureau or similar agency, and none made use of the industry's complaints process.

The TPC considers that there are shortcomings in the internal complaints processes of the life offices, gaps in the coverage of the industry's complaints system and weaknesses in the availability and suitability of the legal remedies open to consumers.

Other research findings

The TPC has also concluded that:

- ◆ The agent remuneration system provides very substantial rewards for new business sales and may therefore encourage inappropriate sales and selling practices which contribute to the high discontinuance rates identified. Notwithstanding recent reforms, there may still be insufficient reward for policy persistency or for 'needs based' selling to distinguish those consumers who require and can afford a long term savings facility from those who don't.
- ◆ While many features on the supply side of the life insurance market indicate that there is strong competition, the market continues to deliver poor value for money to a high proportion of consumers, particularly in the regular premium sector of the market. The root causes of this market failure are the serious information problems facing consumers in this market and the misleading conduct of some agents. In addition to vigorous rivalry among suppliers, effective competition requires numerous, well informed consumers who are able to choose rationally between the offerings of different suppliers. These demand conditions do not exist in the market for life insurance products.

- ◆ The conditions in the market have encouraged competition among suppliers to take the form of bidding up the costs borne by policyholders rather than bidding them down.
- ◆ While informed sources within the industry suggest that 'twisting' could account for as much as 50% of all new business written, the TPC's research was not able to establish the extent of this practice.
- ◆ Consumer problems fall into four main categories: misrepresentations by agents, the non-disclosure of critical information by agents, misplaced confidence and trust that agents are acting in the consumer's interest, and problems consumers have in obtaining equitable dispute resolutions.
- ◆ On balance, there would be benefits for competition and consumers in requiring agents to disclose their commission payments in addition to the disclosure of aggregate fees and charges by life offices.
- ◆ In respect of proposals for some form of occupational licensing/certification/registration for life agents, the TPC is not in a position to make an assessment of the proposals put to it on the basis of the limited information available. This needs to be assessed formally by the TPC under the authorisation provisions of the Trade Practices Act at a later stage.
- ◆ Separate registration of multi agents with appropriate disclosure requirements about their status (and possibly compulsory professional indemnity insurance) should be sufficient to address the multi agent problem provided effective administration and monitoring can be developed.

Recommendations based on TPC's research

The TPC recommends a two stage strategy to address the competition and consumer problems that have been identified in the life insurance market.

Stage one requires the early implementation of measures directed to promoting more effective competition in the market, to improving consumer information on life insurance and superannuation products and to improving the competence and conduct of agents and the availability of remedies for consumers. The TPC's recommendations are numerous but can be summarised under the following headings:

Information disclosure — recommendations aimed at

- ◆ making the relationships between insurers and their intermediaries more visible in the marketplace and making consumers more aware of, and vigilant against, the potential for 'commission bias' in the advice they receive;
- ◆ creating an appropriate 'paper trail' at the point-of-sale, to provide a record of the advice and information disclosed to consumers and to improve the relevance and effectiveness of written and oral point-of-sale information disclosure;
- ◆ improving the timeliness, relevance, comprehensibility and usefulness for consumers of policy documents and other written information; and
- ◆ establishing a consistent and appropriate framework for improved information disclosure about life insurance and superannuation products and to give the disclosure regime legal authority.

Regulation of agents — recommendations that:

- ◆ the LIFA co-regulatory occupational licensing proposal should be submitted to the TPC for assessment under the authorisation procedure of the Trade Practices Act and, in making its determination on that proposal, that the TPC should conduct a comparative assessment of the alternative options (statutory, co-regulatory, self-regulatory or market forces);
- ◆ the Government, in considering its response to the Australian Law Reform Commission/Companies and Securities Advisory Committee's recommendations for rationalisation of the regulation of intermediaries, have regard to the conclusions and recommendations of this report in relation to occupational regulation of life insurance intermediaries and the TPC's authorisation decision in relation to LIFA's co-regulatory occupational licensing proposal.

Consumer redress — recommendations that:

- ◆ measures be taken to improve the effectiveness of, and consumer access to, legal remedies under existing law. Proposals include public enforcement of the Insurance Contracts Act, clarification of the ambit of the Insurance Contracts Act and Corporations Act, removal of uncertainties about consumers' rights and obligations under the Insurance Contracts Act and that Act's relationship with the Trade Practices Act, improvement in the Trade Practices Act's application to insurance, extension of time limits for commencing proceedings, the extension of jurisdiction of tribunals and the like to handle actions in relation to life insurance products and the establishment of specialised tribunals and specialist legal advice centres;
- ◆ other measures be taken to improve consumers' awareness of the LIFA complaints resolution arrangements and to enhance the outcomes obtained by consumers from the internal complaints processes of life offices.

Stage two requires an assessment to be made after three years of the effectiveness of the above measures in addressing the marketing and consumer problems that have been identified in this report. The TPC considers that the assessment of the effectiveness of proposals should be based on the attainment of targets by individual life insurers of some objective measure of improvement in areas such as cohort discontinuance rates, intelligibility of documentation, reductions in complaints about agents' conduct in critical areas like misrepresentations and non-disclosure of fees and charges or surveys to assess individual companies' compliance with the ISC's disclosure regime. The TPC envisages that it should have overall responsibility for this assessment but that the criteria and target levels should be established through consultation with industry, community organisations and the ISC.

Should this assessment indicate that market forces, supported by the program of change proposed in this report, have not been sufficiently effective, consideration may have to be given to other measures such as the setting of minimum surrender values to cover terminations during the early years for regular premium life and superannuation products.