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Financial Services Unit
Financial System Division
The Treasury
Langton Crescent
Parkes ACT 2600

By email (Word and PDF formats)

ProductRegulation@treasury.gov.au

NIBA SUBMISSION IN RESPONSE TO TREASURY LAWS AMENDMENT (DESIGN AND DISTRIBUTION OBLIGATIONS AND PRODUCT INTERVENTION POWERS) BILL 2017 (THE BILL)

The National Insurance Brokers Association of Australia (**NIBA**) appreciates the opportunity to make this submission in response to the Bill.

NIBA is the industry association for insurance brokers across Australia. The association has around 350 member firms, employing over 4,000 insurance brokers in all States and Territories, in the cities, towns and regions of Australia.

ABOUT INSURANCE BROKERS

Insurance brokers work with their clients to assist them to:

- understand and manage their risks, including the risk of loss of or damage to property as a result of adverse weather or other climate related events;
- obtain appropriate insurance cover for their risks and their property; and
- pursue claims under their policies when an insured event occurs, in which case the insurance broker becomes the advocate for the client during the assessment and resolution of the claim.

Insurance brokers act primarily for and on behalf of their client, and they owe legal duties to their clients for the nature and quality of the work they perform on their behalf. When acting for and on behalf of the client, insurance brokers do not SELL insurance policies – they PURCHASE insurance policies on behalf of their clients from the markets available to them.

BACKGROUND

NIBA understands what the Government is seeking to achieve via the Bill in relation to the design and distribution obligations (DDO) and product intervention power (PIP).

NIBA is supportive of fair and reasonable improvements in product design and distribution practices and regulatory powers, implemented in accordance with sound regulatory practice. There must however be a proper cost benefit analysis to show that the benefits clearly outweigh any consumer or industry detriment.

Importantly, new regulatory obligations must take account of existing legal and regulatory obligations, in order to avoid duplication, overlap, confusion and the creation of real difficulties in developing appropriate compliance frameworks and procedures.

NIBA has previously made submissions in the consultation process on the DDO and PIP proposals. NIBA has raised significant concerns regarding the cost benefit analysis conducted in an insurance context and the information provided in support.

NIBA previously recommended a standard cover review as an alternative model for general insurance. NIBA notes this has been included as Recommendation 5 in the report [Australia's general insurance industry: sapping consumers of the will to compare](#). It does not appear to NIBA that there has been any obvious consideration of how the standard cover proposals for general insurance will interact with the Bill and any potential duplication that may result as part of the cost benefit analysis.

Given the Bill has progressed, NIBA will not seek to repeat its past identified concerns, but notes they remain valid.

NIBA notes that there are also current insurance related reviews that can significantly impact on the proposals (e.g. the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry).

We do not believe that it is appropriate to include insurance until proper consultation has occurred to reasonably allow industry, regulators (ASIC and APRA) and Government to –

- identify appropriate and clear minimum obligations in the context of other reforms; and
- undertake a proper cost benefit analysis; and
- determine an appropriate transition period.

If this reasonable approach is not accepted, then urgent discussion is needed in order to develop a reasonable and fair safe harbour framework, equivalent to what was done in the development of the Part 7.7A best interest duty.

The following Executive Summary outlines the main concerns NIBA has with the Bill and the submission then provides detail on each proposed change (including technical ones).

EXECUTIVE SUMMARY

DDO rules should not apply to insurance brokers providing personal advice to retail clients

The December 2016 consultation proposed that licencees providing personal advice would not be subject to the DDO. NIBA does not believe that all of the rules are appropriate where personal advice is provided by an insurance broker on behalf of a retail client because:

- In such a case, the insurance broker must act in accordance with its best interest duty under Part 7.7A (in addition to its general law obligations) which requires the broker to provide personal advice on the personal (not general) suitability of the product for the retail client. The Bill aims to achieve the suitability analysis at a lower 'general' level. The TMD obligations and personal advice obligation also conflict. For example, a clear conflict can arise if the personal advice and TMD are inconsistent.
- Applying rules to protect retail clients that have obtained the greater protection afforded by personal advice adds no real value. It will only unnecessarily increase the compliance costs of insurers and insurance brokers which may be passed to consumers in increased premium etc.
- Applying rules that make the issuer responsible for the conduct of a person acting on behalf of and representing the interests of the client creates a real conflict of interest between the insurer and the broker. Further this is likely to stifle innovation and competition if insurance brokers are forced to act in accordance with insurer directions and not develop new and innovative products and services for their clients.

NIBA believes Treasury and NIBA should engage further on what form of carve outs or amendments are appropriate to avoid these adverse impacts.

DDO proposals risk misleading consumers

NIBA is concerned consumers may be misled by the use of the term 'suitable' which creates a higher expectation (i.e. a personal advice expectation) than that the Bill seeks to achieve.

The proposed changes only require the insurer to reasonably conclude that, if the product were issued or sold to persons in the target market in accordance with the Target Market Determination (TMD) distribution conditions, the product would '**generally** meet the likely objectives, financial situations and needs of the persons in the target market'. [our bold] There is no obligation to ensure the product will be "suitable" for the potential client.

Other than in paragraph 760A(aa), the Bill does not reference the word 'suitable'. The Explanatory Memorandum (EM) uses 'suitable' as well. A new term needs to be used in paragraph 760A(aa) (e.g something like 'general suitability...') and the use of 'suitable' amended in the EM and any public announcements to refer to 'general suitability'.

NIBA also believes that it is important to make it clear in the legislation that complying with the DDOs or issuing a TMD does not of itself constitute personal advice. Consumer should not be misled in this respect and a warning to that effect is very important.

A failure to do so may reduce the number of consumers seeking personal advice (reducing competition and innovation) and could have a significant adverse impact on insurance brokers and consumers and insurers seeking to compete with the existing retail client insurers. In addition, the less the community seeks personal advice, the less informed the community will be in relation to the nature and extent of their risks and the nature and level of their insurance protection.

Lack of clarity will have a significant adverse impact on insurance industry and retail clients

NIBA raises specific issues below on the Bill's provisions regarding the lack of certainty. In short, the practical application of these general principles-based rules (ie where the line should be drawn) will not be clear until the issue of regulations and/or ASIC guidance after implementation.

As currently drafted, they require what would be (without clarification) significant and impractical/unworkable steps to be taken by the insurance industry (we explain these below). There also is no safe harbour regarding compliance equivalent to that in Part 7.7A – best interest duty – which faced similar problems. Of note:

- Lack of clarity gives rise to likely compliance inconsistency and uncertainty within the industry and lead to increased costs for insurers, insurance brokers (many of whom are small businesses) and ultimately consumers.
- Insurers may restrict the number of products available to reduce costs, restricting innovation. Small businesses, finding the compliance burden too onerous, may exit the market, restricting competition and innovation. Insurers may themselves find the burden to great, and restrict product offerings to a limited range of standard policies.

We understand that the DDO are not designed to prohibit dealings or advice where inconsistent with the TMD. This should be confirmed in the EM.

ASIC guidance, once issued, may not be acceptable to industry (or could be changed after the fact as it is not law) and NIBA is concerned that the actual cost benefit analysis cannot properly be done until ASIC position is known.

NIBA requests clarification on when draft guidance is to be made available for industry feedback. If it is not yet available, it will be appropriate to have industry associations liaise with ASIC to obtain a clearer idea of what is expected.

Indeed, NIBA believes it would be particularly helpful if Treasury and/or ASIC could provide, well prior to the finalisation of the legislation, an indication of a typical TMD in the area of general insurance, for a comprehensive motor policy, a home buildings policy and a travel policy. This would provide the industry with a much clearer idea of what might be required to comply with the requirements of the legislation.

PIP and other ASIC DDO powers

NIBA is of the view ASIC has sufficient powers to achieve its regulatory objectives from its existing toolkit despite representations to the contrary and has covered this in various other submissions. Relevant to FSI recommendation 22, the intervention power was expected to be used infrequently and as a last resort. This should be made clearer.

NIBA is concerned that subjectivity can lead to inappropriate use of powers. A recent concern in this regard was the ASIC Life claims review and the broader recommendation made regarding general insurance, which to our knowledge were never the subject of inquiry or consultation as part of that project.

Whilst NIBA notes a number of practical matters for consideration, its main concern is that PIP orders now extend to remuneration where the remuneration is conditional on the achievement of objectives directly related to the financial product (despite the December 2016 consultation paper). The lack of clarity and breadth of

the power is extremely concerning for NIBA as is the risk of ASIC seeking to change existing general insurance remuneration arrangements and operation of the laws as they currently relate to general insurance by use of this power.

No evidence has been provided in recent years indicating that remuneration arrangements for insurance brokers is resulting in poor quality advice, and poor consumer outcomes. Changes to remuneration arrangements could well have serious impacts on the viability of businesses, the way in which they operate, and ultimately the nature and level of advice that would be available to the community on risk and general insurance matters.

NIBA firmly submits that any regulatory measures in relation to remuneration frameworks should only be considered on the basis of clear evidence of concern, and full consultation on potential mechanisms to remedy those concerns. That has not occurred to date in relation to remuneration arrangements for general insurance brokers.

DDO and PIP Commencement

Without details of how the DDO and PIP rules will practically apply, NIBA cannot reasonably identify if the time for transition is appropriate or not. These are significant reforms and are likely to require major systems and compliance changes. NIBA expects that the current proposed timing is too short. As with the FOFA changes to the Corporations Act, NIBA recommends that there also be a 12 month facilitative compliance approach taken by ASIC.

NIBA queries whether it is appropriate to initially exclude insurance until the significant practical issues that arise can be properly resolved and the interaction between the standard cover proposals and these reforms are properly determined.

A similar approach appears to have been taken in the UK where consultation continues on its IDD (Insurance Distribution Directives). We also note there are current:

- [Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry](#)
- [Northern Australia insurance inquiry](#)
- [Consumer protection in the banking, insurance and financial sector](#)

which are worthy of consideration once finalised.

Grandfathering

NIBA believes that those wishing to amend distribution arrangements subject to FOFA grandfathering with the aim of applying some of the new DDO obligations,

should not lose the grandfathering protection. This would be unfair and act as a disincentive to improving practices.

Conclusion

There are two key questions that need to be answered in relation to the impact of this Bill on insurance brokers. NIBA submits these questions need to be clearly addressed before this Bill progresses further.

1. Where insurance brokers are acting for and on behalf of their client, and are providing personal advice to their client under existing legal and regulatory frameworks – including the statutory Best Interests Duty, what additional protection does this Bill provide to clients, given the standard of care imposed by the Bill is less than the standard of care required for personal advice to retail clients?
2. If it is in the client's best interests to purchase a particular policy, but the client does not fall within the target market for that policy as set out in the TMD, which statutory duty does the insurance broker breach? The best interest duty, or the duty to distribute products in accordance with the TMD?

We set out below NIBA's detailed submission.

NIBA DETAILED SUBMISSION

PRODUCTS CAUGHT BY DDO

Only products which require disclosure in the form of a product disclosure statement (PDS) under Part 7.9 (Financial product disclosure) of the Corporations Act are caught.

In the insurance context, this will include general and life insurance issued to retail clients (including group policies caught by s1012H Obligation to take reasonable steps to ensure that Product Disclosure Statement is given to person electing to be covered by group financial product) and other risk management products (e.g discretionary mutuals) for which a PDS is required.

NIBA comments

Where an insurer packages a number of different covers (e.g a Business or farm pack) within a single contract (some within the retail client product definitions and some not), the PDS requirements only apply to the retail cover part of the contract not the whole contract – See s 761G (5) and regulations.

*For example, for the purposes of the retail client definition and PDS preparation, the approach is that only the part of the policy that is retail is caught. The regulations make this clear see for example – ‘Regulation 7.1.12 - For Subparagraph 761G(5)(b)(ii) of the Act, a home building insurance product is a contract **or part of a contract** that provides insurance cover (whether or not the cover is limited or restricted in any way) in respect of destruction of or damage to a home building.’ [our bold]*

The obligations seem to only apply to the retail cover part of the contract. The intent should be clarified and clearly stated in the EM.

It would be inappropriate to apply the rules to non-retail type covers, e.g. business interruption, public liability, Management Liability, professional indemnity, etc.

WHEN DO THE DDO CHANGES APPLY FROM?

The new design and distribution regime applies to:

- an existing financial product which is one where:
 - the ‘first issue’ of the product occurs before the commencement of Schedule 1 of the Bill i.e. the day after 12 months from Royal Assent);
 - and
 - a further issue occurs on or after the end of the commencement date
- **24 months after the new law receives the Royal Assent;**

- all other financial products - **12 months after the new law receives the Royal Assent.**

NIBA comments

Does 'first issue' in the insurance context mean new business contract only? i.e. excludes variations and renewals.

Does 'further issue' mean renewals in the insurance context?

The TMD trigger is not the issue of a new PDS. This means a TMD must be done once the legislation commences for the relevant product.

What will be the position for products with terms longer than 24 months issued before the commencement of Schedule 1 of the Bill? They would be subject to a TMD obligation mid term. What would the expectations be pre-renewal? It is unclear to NIBA what would be required.

Transition offering issues: how is it expected quotes/offers made before the Target Market Determination (TMD) issue date which are accepted after the TMD is issued should be treated? It is unclear to NIBA what would be required.

What is expected for renewals once new law is in effect? Is an insurer meant to consider the TMD against its renewal portfolio in any way and if so how? It is unclear to NIBA what would be required.

If customer is forced to recomplete the process they can be exposed to an uninsured risk and possible pricing increases. In addition, where represented by an insurance broker providing personal advice the process would be unnecessary.

Without details of how the rules will practically apply, NIBA cannot reasonably identify if the time for transition is appropriate or not. These are significant reforms and are likely to require major systems and compliance changes. NIBA expects that the current proposed timing is too short.

As with the FOFA changes to the Corporations Act, NIBA recommends that there also be a 12 month facilitative compliance approach taken by ASIC.

NIBA believes it may well be appropriate to initially exclude general insurance until the significant practical issues that arise can be properly resolved and the interaction between the standard cover proposals and these reforms are properly determined.

A similar approach appears to have been taken in the UK where consultation continues on its IDD (Insurance Distribution Directives). We also note there are current:

- [Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry](#)
- [Northern Australia insurance inquiry](#)
- [Consumer protection in the banking, insurance and financial sector](#)

which are worthy of consideration and can have a significant impact on the issues the subject of the Bill.

DESIGN OBLIGATIONS

The design obligations apply to the issuer

For insurance this is the insurer i.e. the person ultimately responsible for the obligations under the product and for preparing the PDS. Agents or other entities that may assist in the design of the product itself are not caught, as we read the Bill.

NIBA comments

No concerns.

Obligation to determine the target market

The issuer must make a *target market determination* for the product before a person deals in the product or provides financial product advice in relation to the product.

The target market determination must:

- be in writing;
- describe the class of persons who comprise the target market for the product; and
- set out any conditions and restrictions on dealings in, or providing financial product advice in relation to, the product, other than a condition or restriction imposed by or under the Act (**distribution conditions**).

Examples of distribution conditions for a financial product are listed as:

- a condition that the financial product not be issued to a person unless the person has received personal advice; and
- restrictions limiting the distribution of the product to specified distribution channels.

- be such that it would be reasonable to conclude that, if the product were issued or sold to persons in the target market in accordance with the distribution conditions, the product would generally meet the likely objectives, financial situations and needs of the persons in the target market.

NIBA comments

The biggest issue is the lack of clarity and the compliance risk this creates for insurers, their agents and others.

Identifying the target market - At what level must a target market be identified? Is it:

- *at the 'type of cover' level of choice e.g Motor Comprehensive insurance vs Third Party Fire and theft or Third party property damage – e.g anyone with a car.*
- *more than this and if so, where is an insurer expected to stop? Is it:*
 - *For all cover benefits or only some? How would it work where the product has various options that may or may not be appropriate for various sub classes etc? For example, each product has additional benefits provided under the cover (automatic or optional), excess levels, cover limits and exclusions and other conditions of the product in determining the target market;*
 - *any characteristic that remove a person from eligibility (e.g type of insured item, value of insured item, location of insured/insured item and at what level (e.g State, area code) in effect the non-target market? A TMD could become a complex document. It may also provide competitors with commercially sensitive information and potentially breach competition laws.*

NIBA is concerned that the above will give rise to market inconsistency and without clarification, high compliance costs and an unfair exposure to compliance breaches. Taking the position that ASIC will clarify it afterwards and you can 'trust' them to get the right balance, does not fill the industry with any confidence.

By way of example, the recent ASIC Life Claims review and recommendations made regarding general insurance is a very recent instance of where ASIC can act in a manner that industry can justifiably be concerned about. How a regulator in a review of life insurance can reasonably recommend a broad change to claims in general insurance (that were not reviewed) still puzzles NIBA. To date, NIBA is not aware of the issue being addressed.

Identifying the likely objectives, financial situations and needs of the persons in the target market - There is no guidance in an insurance context on how you determine with any certainty what these likely objectives, financial situation and needs might be and at what level. We repeat our concerns above about being reliant on ASIC guidance issued after the fact for certainty.

Everyone has, at different levels, different objectives, financial situations and needs. NIBA is unclear on how an insurer could realistically work out where the line should be drawn in a way that satisfies itself that it complies with the law. There is no safe harbour equivalent to that in Part 7.7A – best interest duty – that faced similar problems. There is likely to be a lack of consistency within the market.

By way of example:

- Do you look at the 'objective' or 'need' at the 'type of cover' level (e.g Comprehensive motor insurance vs other options) or lower levels such as limits of the cover - agreed value vs market value/limit of liability cover or lower still re additional benefits such as new for old replacement, excess levels, rental car and so on. The Bill does not limit how far the insurer must go.
- What happens if the 'need' of home owners includes cover which is not provided by the insurer for a valid commercial reason. This could prevent insurers offering existing products in the market. This cannot be the intent but it is how it operates as drafted.
- If a target market must be location specific the likely need for customers in that area will be different. This could have an anti-competitive effect if one insurer's limited distribution channel forces them to meet needs that an insurer with a broader distribution channel would not.
- NIBA is unclear on how the general 'financial situations' of a target market could ever sensibly be determined and at what level this analysis is required.

In effect, Government is proposing to implement legislation where the actual impact on the industry and consumers is not and cannot be known and industry is reliant on a regulator to set the rules. NIBA has real concerns the rules cannot properly be determined.

If insurance is to be included in the Bill, despite our submission to the contrary that it be excluded until all relevant issues are properly considered, urgent discussion is needed in order to develop a reasonable and fair safe harbour provision, equivalent to what was done in the development of the Part 7.7A best interest duty.

Determining what Distribution conditions to apply - Insurers must 'set out any conditions and restrictions on dealings in, or providing financial product advice in relation to, the product, other than a condition or restriction imposed by or under this Act' (**distribution conditions**).

The Bill includes examples of distribution conditions:

- a condition that the financial product not be issued to a person unless the person has received personal advice; and

- *restrictions limiting the distribution of the product to specified distribution channels - s993DB (9)(b) Note.*

As drafted the Bill leaves the distribution conditions to be set at the discretion of the insurer. There is no obvious obligation regarding what these must be. Only the ASIC PIP imposes any potential restrictions in this regard with the ability to restrict conduct.

Section 993DB(10) requires the insurer to satisfy itself that 'it would be reasonable to conclude that, if the product were issued or sold to persons in the target market in accordance with the distribution conditions, the product would generally meet the likely objectives, financial situations and needs of the persons in the target market'. [our italics]

As we read the above, all an insurer needs to do is satisfy itself that it would be reasonable to conclude that if the product were sold to a person in the target market, the product would generally meet their likely objectives, financial situations and needs.

The words 'in accordance with the distribution conditions' add little in this context as an insurer could say 'distribution condition – sale by telephone only' and technically comply.

Does Treasury agree with this view and if not, could it please provide further clarity on why.

The result is contrary to the examples provided and the expressed intent in the previous discussion paper which noted that:

'The selection of distribution channel or marketing should be influenced by the controls that distributors put in place to ensure that the products reach the identified target market. For example, a distributor that reaches a range of consumers that is broader than the identified target market could still represent an appropriate distribution channel if the distributor has in place strong controls to restrict the sale of the products to consumers outside the desired target market...'

Assuming that the intent is to have insurers impose distribution conditions, it is unclear how these should be determined and at what level (high level type of cover choices or additional and optional benefits, excesses, exclusions etc?) of detail. Too much detail can result in confidential or commercially sensitive information being made available to competitors and/or a breach of competition laws.

In addition, in the sales process when would ASIC expect a knock out of a non-target market customer vs a warning? People may not be in the target market but want to buy the cover because of their personal circumstances which an insurer would not be aware of. Is the intent to force insurers to build personal questions into the sales process to extract personal information allowing the insurer to determine when to offer cover or not. Again, where should the line be drawn? Significant systems changes would be required, and the costs would also be very high.

How would renewal business be treated? Is it intended that there be a new positive obligation on insurers to consider and review the renewal book of business against distribution condition knock outs? If so, this would have an adverse impact on insurers (with

the significant systems changes that would be required) and ultimately consumers with premium increases and their insurance broker representatives that would also have to make system changes, implement new procedures and so on.

Similar issues arise for variations/endorsements which relate to a policy that was entered into pre-TMD and then varied afterwards.

NIBA also believes that it is important to make it clear in the legislation that provision of a TMD does not constitute personal advice of itself. Consumer should not be misled in this respect and a warning to that effect is in NIBA's view very important.

When is it reasonable to conclude that, if the product were issued or sold to persons in the target market in accordance with the distribution conditions, the product would generally meet the likely objectives, financial situations and needs of the persons in the target market?

The main hurdles in forming a view are:

- identifying what the target market is and where the line should be drawn as discussed above;*
- what the **likely objectives, financial situations and needs** of the target market actually are and at what level as discussed above. In addition, if it doesn't, irrespective of how unreasonable these may be, the product cannot be sold as the next test can't be satisfied;*
- what distribution conditions are actually expected given the problems with the Bill raised above;*
- how you determine whether the product would '**generally**' meet the likely objectives, financial situations and needs of the target market. Whether this is the case and to what extent is unclear – is it all of the target market's likely needs or only 50%, 60% or more that needs to generally be met?*

If these matters are left unclear industry is left with unworkable legislation, the cost impact of which is unknown. To avoid breaching this principles based legislation with no low water mark, industry must apply the principles at their broadest. There will be inconsistency in how this will be done leading to confusion and disadvantage to those seeking to apply better compliance practices.

Waiting for ASIC on guidance that may be unreasonable is not a sound regulatory outcome.

If insurance is to be included in the Bill, despite our submission to the contrary that it be excluded until all relevant issues are properly considered, urgent discussion is needed in order to develop a reasonable and fair safe harbour equivalent to what was done in the development of the Part 7.7A best interest duty.

It is important to make it clear in the legislation that provision of a TMD does not constitute personal advice itself. If not there is likely to be confusion in this respect and we do not want consumers believing the contrary to their detriment.

We note that the EM at 1.40 does not reflect the wording of the Bill which refers to 'generally meet the likely objectives, financial situations and needs of the persons in the target market'. This should be amended.

Building TMD into other documents such as PDS

NIBA assumes:

- there is no prohibition against building the TMD into a PDS or other document.*
- it is not intended that issuers be required to build the TMD into every PDS.*

Confirmation should be included in the Bill or otherwise in the EM or via ASIC.

For all the reasons stated above, NIBA believes it would be particularly helpful if Treasury and/or ASIC could provide, well prior to the finalisation of the legislation, an indication of what a typical TMD might contain for products in the area of general insurance, for a comprehensive motor policy, a home buildings policy and a travel policy. This would provide the industry with a much clearer idea of what might be expected/required in order to comply with the requirements of the legislation.

Obligation to review the target market determination

An issuer must review a target market determination as necessary to ensure it remains appropriate. The EM notes that the obligation is particularly pertinent for complex products and products that are likely to be issued over an extended period of time.

The obligation stipulates that a person who makes a target market determination must at the same time:

- identify events and circumstances (called '**review triggers**') that would reasonably suggest that the target market determination is no longer appropriate; and
- determine the maximum period between reviews of the target market determination (called the '**review period**'), which must be reasonable in the circumstances.

The EM states that what 'can constitute a review trigger will vary from product to product depending on the nature of the product and the circumstances surrounding its issue, including the way in which it is distributed'. However, some examples provided include:

- an event or circumstances that would materially change a factor taken into account in making the target market determination for the product;
- the discovery of a material and relevant defect in the product's disclosure documentation;

- whether the product is being distributed and purchased as envisaged by its target market determination; and
- the nature and extent of any feedback received from those who distribute or invest in the product.'

NIBA comments

Again, there is no compliance certainty where the required TMD content is unclear and there is no low water mark. NIBA is concerned that a TMD is no longer 'appropriate' if there is only a minor flaw. A significance test should be considered.

Issuer TMD record keeping obligation

An issuer must keep records of their decisions about:

- a product's target market determination, review triggers and review period; and
- the reasons for those decisions.

NIBA Comments

No major concerns

Obligation to notify ASIC of significant dealings that are not consistent with a product's target market determination

An issuer must notify ASIC in writing as soon as practicable, and in any case within 10 business days of 'significant dealings' in a product that are not consistent with the product's target market determination.

'Significant' is not defined for the purposes of the new obligation and is intended to take its ordinary meaning in the context of the new provision. The EM states that 'Generally, this would require an issuer to inform ASIC of dealings that would be worthy of its attention having regard to the object of the new regime and ASIC's role as its regulator. However, ultimately whether or not a dealing is significant would be a matter to be determined in the circumstances of each case.'

The EM states that 'This notification obligation supports the effectiveness of the new regime. In particular, it ensures that ASIC is advised, where possible, of significant dealings in a product that are not consistent with its target market determination. By

doing so, the requirement assists ASIC in making timely and appropriate decisions in support of the new regime.'

NIBA Comments

It applies to significant 'dealings' and 'dealing' is a defined term. As advice is also caught (which is not 'dealing'), this may be intended to be broader i.e. not refer to define dealing, but it is not clear.

The term 'significant' creates yet more compliance uncertainty for industry. The EM attempts to provide guidance but this provides little help to industry and could be seen as going beyond the words used.

The EM refers to 'object' of the legislation which is expressed in the Bill as 'the provision of suitable financial products to consumers of financial products.' The word 'suitable' is not otherwise used in the amendments and is broader than the legislative obligation. See earlier comments.

DISTRIBUTION OBLIGATIONS

Who it catches

The obligations apply to 'Regulated persons', which will catch:

- an issuer of the financial product; or
- any financial services licensee; or
- any authorised representative of a financial services licensee; or
- any person who is not required to hold an Australian financial services licence because the person is covered by:
 - paragraph 911A(2)(j); or
 - an exemption in regulations made for the purposes of paragraph 911A(2)(k); or
 - an exemption specified by ASIC for the purposes of paragraph 911A(2)(l); or
- any person who is required to hold an Australian financial services licence but who does not hold such a licence.

NIBA comments

This will catch the insurer and its agents but also insurance brokers acting for the client not the insurer.

NIBA does not believe it is appropriate for insurance brokers providing a retail client with personal advice to be caught. In such a case, the insurance broker must act in accordance with its best interest duty under Part 7.7A (in addition to its general law

obligations) which requires the broker to provide personal advice on the suitability of the product for the retail client.

This is what the Bill aims to achieve at a lower general level.

Applying rules to protect retail clients that have sought to obtain the greater protection afforded by personal advice will unnecessarily increase the compliance costs of insurers and insurance brokers for no benefit for the consumer that may ultimately have these increased costs passed to them in increased premium etc.

NIBA is not aware of any evidence of any level of failure of general insurance brokers providing personal advice that would justify them being caught.

Obligation not to deal or advise unless a target market determination has been made

A regulated person must not deal in, or provide financial product advice in relation to, a caught product unless a TMD for the product has been made in accordance with the Act.

A regulated person must also notify ASIC as soon as practicable, and in any case within 10 business days, if the person becomes aware that they have contravened this obligation.

In any proceedings against a person for breach of this obligation (not being the issuer that made the determination), it is a defence if:

- the person who is required to make the TMD (the insurer) notified the regulated person ***[typo – expect intent is in writing]*** that it had made a TMD; and
- the regulated person's failure to comply occurred because the regulated person was acting in reliance on that notice; and
- the regulated person's reliance on that notice was reasonable.

The EM states that 'This means that a regulated person does not need to make undue inquiries as to the compliance of a target market determination with the requirements of the new regime. However, where reliance on a determination is not reasonable, for example, because it is not in writing or ***appears inappropriate***, the regulated person must make necessary inquiries or not distribute the product.'

NIBA Comments

See comment on notice issue above.

A non-compliant TMD in any form whether significant or not is not 'appropriate'. This means that in most cases a regulated person will need to notify ASIC under 993DD(3). A significant dealing type test should be applied to avoid wasted costs.

What Government considers are 'undue inquiries' is not clear.

Practically, the requirement forces all regulated persons to have procedures in place to obtain any TMD (also ensure they have the latest) and consider its appropriateness at the start and on an ongoing basis having regard to its knowledge.

There is no obligation on an issuer to provide a determination to a regulated person. NIBA believes insurers should be required to have a TMD and the latest versions available publicly online.

Applying the changes to processes immediately once notified of a TMD will also be an issue.

This creates a significant new compliance obligation on insurance brokers (many of which are small businesses) which have multiple relationships with insurers (in some cases in the 100s) and in relation to multiple retail products (again in the 100s).

As there is not likely to be insurer consistency in TMDs and given the number of products, this will give rise to compliance overload.

This will significantly adversely affect such intermediaries and create an overwhelming compliance burden. The cost is likely to be passed to consumers.

The above may also have the effect of reducing the availability of personal advice to consumers if insurance brokers consider the cost of compliance to be too great.

The above can prevent an insurance broker from providing any personal advice in relation to product to the client. This could cause them to breach a duty to their client and expose the customer to an uninsured risk. This is another reason why insurance brokers providing personal advice to retail clients should be exempt.

Obligation not to distribute where target market determination may not be appropriate

A target market determination may not be appropriate if the issuer knows, or ought reasonably to know, that:

- a review trigger has occurred; or
- another event or circumstance has occurred that would reasonably suggest that the determination is no longer appropriate.

Issuers are prohibited from dealing in, or providing financial product advice in relation to, the product until they have reviewed the determination and, if necessary, made a new determination.

They must also, as soon as practicable, take reasonable steps to ensure regulated persons are directed not to distribute the product until they are notified that the review is complete, and where applicable, are notified of the new determination. A regulated person must comply with any such direction.

NIBA comments

We do not believe this requirement is appropriate where an insurance broker provides personal advice on behalf of a customer where they have an existing obligation to act in the best interests of the customer under Part 7.7A. A TMD is not appropriate if there is a minor flaw and this means any advice and dealing services must cease.

A significance test should be included as this can leave insureds exposed to uninsured risks and cause major loss of revenue and compliance costs.

The ostensible knowledge test (i.e. reasonable ought to know) is not in NIBA's view appropriate given a breach of this requirement in s993DC(3) gives rise to criminal and civil penalty liability. It should be limited to actual knowledge.

The prohibition is also triggered by the non-compliant event and there is no leeway in terms of reasonable reaction time.

Obligation to take reasonable steps to ensure compliance with a target market determination

An issuer must take reasonable steps to ensure that dealings in, and financial product advice provided in relation to, the product are consistent with the most recent determination.

A regulated person who deals in, or provides financial product advice in relation to, a financial product for which a target market determination has been made must also take reasonable steps to ensure that the dealing or advice is consistent with the most recent determination.

'Reasonable steps' means steps that are, in the circumstances, reasonably able to be taken to ensure that dealings in and advice about a product are in accordance with its target market determination.

In making this assessment, the regulated person must take into account *all relevant matters*, including:

- the likelihood of their dealings or advice resulting in a person acquiring a product otherwise than in accordance with its target market determination (that is, the likelihood of the risk);
- the nature and degree of harm that might result from the product being issued otherwise than in accordance with the determination (that is, the consequence of the risk);
- the availability and suitability of ways to eliminate or minimise the likelihood and the harm (that is, the extent to which the risk may practicably be mitigated); and
- what the *responsible person* knows, or ought reasonably to know, about the matters referred to above (that is, the responsible person's understanding of the risk and ways to mitigate it).

The EM notes that this 'ensures the obligation is scalable according to the risk associated with an inappropriate distribution of a product and the practicability of mitigating the risk. For example, other things being equal, the content of the obligation would be greater for a complex product with a high-risk profile than for a simple product with a low risk profile. However, what constitutes 'reasonable steps' will ultimately depend upon the circumstances of each case.'

NIBA comments

Not knowing what the TMD content will comprise makes it difficult to comment, other than noting that the obligation is subjective and open to argument.

Generally speaking 'Reasonable steps' usually involves a consideration of whether a reasonable person in that position and circumstance would have taken the same approach (see ASIC v Australian Property Custodian Holdings Ltd (No 3) [2013] FCA 1342).

Clarification is needed on whether the obligation is intended to apply to the issuer's own distribution, distribution by third party regulated persons, or both.

We do not believe this is appropriate where an insurance broker provides personal advice on behalf of a customer as they have an existing obligation to act in the best interests of the customer under Part 7.7A. The effect of the obligation could be to have issuers review a broker's personal advice to a client. This in turn could lead to personal advice being provided by the issuer in forming a contrary view.

As noted previously, if insurance is to be included in the Bill, despite our submission to the contrary that it be excluded until all relevant issues are properly considered,

urgent discussion is needed in order to develop a reasonable and fair safe harbour provision, equivalent to what was done in the development of the Part 7.7A best interest duty.

Obligation to collect distribution information

The issuer and any other regulated person (i.e. agent of insurer or brokers) must collect, and keep records of:

- the number of issues of the product that the person makes (only the insurer will issue); and
- the dollar value of the issue of the product that the person makes; and
- the proportion of the number of issues of the product that the person makes that were consistent with the determination; and
- the ways in which the person's dealings in, or the person's providing financial advice in relation to, the financial product occurred; and
- the steps the person took to ensure compliance with the product's target market determination (that is, the steps to comply with the third distribution obligation).

Distribution information may also be requested by ASIC to support its enforcement of the new regime. The regulations can impose requirements about distribution information.

NIBA comments

NIBA requests clarification on:

- *whether the first 3 obligations only apply to insurer and/ or a binder agent that are authorised under the Corporations Act to 'issue' products. The term 'issues' is not defined. What is the intent here?*
- *what happens if an issuer or regulated person does not have access to the information (i.e. it is held by the issuer/regulated person). Failure to comply with this obligation is a criminal offence and a civil penalty provision and given this we submit that the obligation only apply to information 'actually known by' the relevant person.*
- *whether any competition law risks have been considered?*
- *the level of detail required regarding 'the ways in which the person's dealings in, or the person's providing financial advice in relation to, the financial product occurred'.*

A relevant person must provide the information to ASIC on request by 'the date specified in the request'. A breach results in a significant criminal offence and civil penalty. Given this NIBA submits that a minimum period of time or reasonable period

of time qualification be included. A reasonable excuse defence, similar that in s63(5) of the ASIC Act should be considered.

Obligation to notify issuer of significant dealings that are not consistent with a product's target market determination

A regulated person must notify a product's issuer in writing, as soon as practicable, and in any case within 10 business days, of *significant dealings* in a product that are not consistent with the product's target market determination.

'Significant' is not defined. The EM states that 'Generally, this would require a regulated person to inform an issuer of dealings that would be worthy of their attention having regard to the object of the new regime and the issuer's role as the product's designer. However, ultimately whether or not a dealing is significant would be a matter to be determined in the circumstances of each case.'

NIBA comments

We do not believe this is appropriate where an insurance broker provides personal advice on behalf of a customer where they have an existing obligation to act in the best interests of the customer under Part 7.7A. This would appear to mean an insurance broker would have to compare their personal advice against an insurer's TMD in every case. This is unworkable.

This applies to significant 'dealings' and 'dealing' is a defined term. As advice is also caught (which is not 'dealing'), we assume the intent is broader. Please clarify.

Promotional material must refer to target market

Currently, section 1018A of the Corporations Act requires advertising and promotional material for a financial product to refer to a product disclosure statement. The new law amends section 1018A to require:

- An advertisement or published statement (that is reasonably likely to induce people to acquire the product) in relation to the product to describe the target market or specify where the description is available.
- Where a product is reasonably likely to become available for acquisition by retail clients, any advertisement or published statement in relation to the product to describe the target market or specify where the description is available.

NIBA comments

No comments.

ASIC'S POWERS AND ASSOCIATED MATTERS

The new law gives ASIC powers to support its regulatory role with respect to the new obligations. In particular, ASIC is provided with powers to:

- request information relevant to its regulatory role;
- issue stop orders in relation to suspected contraventions of the new regime; and
- make exemptions and modifications to the new regime.

Information gathering power

ASIC will have information gathering powers to obtain information concerning:

- distribution information that a regulated person possesses or has access to and
- records the issuer must keep under the new regime.

The new law sets out the process by which ASIC must request information and how it ought to be provided. Specifically:

- ASIC's request for the information or records must be in writing; and
- the response to a request must be in writing and given to ASIC by the date specified in the request, or if no date is specified, within 10 business days after the day the person receives the request.

NIBA Comments

ASIC can specify an unreasonable time. A minimum reasonable time should be included.

Stop orders power

The new law gives ASIC the power to make a stop order with respect to certain contraventions of the new regime. The relevant contraventions are those relating to:

- a failure to make a target market determination;
- dealing in, or providing financial advice in relation to, a product without a determination; and
- failing to take reasonable steps to comply with a determination.

NIBA Comments

The main concern is that the interim order power could be exercised improperly based on a subjective view as to whether the TMD is compliant or not e.g re review dates or distribution conditions etc. This is concerning as ASIC could shut down a market and cause significant industry and consumer detriment.

NIBA is concerned that subjectivity can lead to inappropriate use of powers.

Given the serious consequences of a stop order, we request that the subjective test be made objective, ie that ASIC must be satisfied 'on reasonable grounds'.

A stop order can also include a statement that specified conduct engaged in contrary to the order is deemed to be a breach of a 'specified provision of this Part'.

This is in effect a deemed breach of other provisions of the Act that are not breached by the conduct in question. This appears to be unfair and unusual to NIBA and likely to create uncertainty. Is there further clarity that can be provided in this regard?

Exemption and modification powers

The new law gives ASIC the power to make exemptions and modifications to the new regime. In particular, ASIC may:

- exempt a person or class of persons from all or specified provisions of the new regime;
- exempt a financial product or a class of financial products from all or specified provisions of the new regime; or
- declare that the new regime applies in relation to a person or financial product (or class of person or products) as if specified provisions were omitted, modified or varied as specified in the declaration.

NIBA Comments

The ability for ASIC to modify the law in this way is concerning to NIBA. NIBA has referred above to a recent example (Life claims review) of where ASIC appears to have acted in a manner that is inconsistent with good regulatory practice.

Consequences of breaching the new provisions

The consequences of breaching the new provisions fall into two main categories:

- liability to the state through civil penalty proceedings or criminal prosecution; and
- liability to persons suffering loss or damage through civil action.

NIBA comments

Given the lack of clarity and subjectivity of compliance the above consequences are concerning to members. This is likely to either result in a reduction in services due to the risks (reducing competition) or create overcompliance and ultimately, additional costs for consumers for little obvious added benefit.

ASIC PRODUCT INTERVENTION POWER (PIP) FOR ASIC TO PREVENT OR RESPOND TO SIGNIFICANT CONSUMER DETRIMENT

Reason for the changes

ASIC has powers under certain parts of the Corporations Act to impose conditions and take actions to rectify consumer detriment *after* a breach or suspected breach of the law. However, these powers provide ASIC with limited scope to regulate proactively.

NIBA comment

NIBA does not agree with this view.

NIBA is of the view ASIC has sufficient powers to achieve its regulatory objectives from its existing toolkit despite representations to the contrary and has covered this in various other submissions. Relevant to FSI recommendation 22, the intervention power was expected to be used infrequently and as a last resort. This should be made clearer in the EM.

What products are caught?

Under the Corporations Act, the intervention power generally only applies to financial products that are, or are likely to be, available for acquisition by retail clients by way of issue.

NIBA comments

No comment.

When can the intervention power be used?

It can be used where ASIC is satisfied that a product or class of products has resulted, or is likely to result, in significant detriment to relevant persons (ie retail clients).

'Significant' is not defined and its meaning is intended to take its ordinary meaning in the context of the new provision. Generally, this would require the detriment to be

sufficiently great to justify an intervention, having regard to the circumstances of the case and the object of the intervention power.

The new law provides non exclusive guidance about matters that must be considered in determining whether a detriment for the purposes of the new power is significant.

A product's compliance with existing provisions of the law may be relevant to whether it is likely to cause significant consumer detriment. However, a product may cause such detriment even if it complies with all applicable laws. In particular, a product may result in significant detriment to consumers even if a person has complied with all applicable disclosure requirements, and with the person's design and distribution obligations, in relation to the product.

NIBA Comments

Given the subjectivity of exercise of the power, the above is concerning to members. NIBA has referred above to a recent example (Life claims review) of where ASIC appears to have acted in a manner that is inconsistent with good regulatory practice.

Given the serious consequences of a stop order and the PIP, we request that the subjective test be made objective, ie that ASIC must be satisfied 'on reasonable grounds'.

A lack of guidance as to what a significant detriment would be for the purpose of the PIP and lack of granularity and guidance regarding the types of orders that may be made are matters of concern. NIBA believes that ASIC should only make orders that are reasonably necessary to remedy or address the significant detriment and that are proportional to the identified significant detriment.

When does the power apply?

The power applies from the day after the Royal Assent. However, the power is not retrospective. It only applies in relation to products that are acquired by consumers on or after the commencement date.

NIBA comments

Despite what the EM states, the power is retrospective in that it can apply to a product signed off before commencement and sold after.

NIBA queries whether the power should mirror timing of design and distribution changes to allow industry to implement such changes. If not ASIC could in theory

apply the power while industry is implementing the design and distribution changes. This would be unfair.

What is the content of the new intervention power and how is it exercised?

The new power allows ASIC to make an intervention order that may last for up to 18 months, unless it is extended by the Minister.

NIBA comments

This is a significant period of time.

Intervention orders

Under an intervention order, ASIC may make three types of orders in relation to a product or class of product:

- a person must not engage in specified conduct in relation to the product;
- a person must not engage in specified conduct in relation to the product except in circumstances specified in the order; or
- a person must not engage in specified conduction in relation to the product unless steps specified in the order have been taken.

NIBA Comments?

Given the subjectivity of exercise of the power, the above is concerning to members. NIBA has referred above to a recent example (Life claims review) of where ASIC appears to have acted in a manner that is inconsistent with good regulatory practice.

A PIP order can include a statement that specified conduct engaged in contrary to the order is deemed to be a breach of another provision. This means that it is in effect a deemed breach of other provisions of the Act that are not breached by the conduct in question. This appears to be unfair and unusual and likely to create uncertainty.

Intervention orders now extend to remuneration where the remuneration is conditional on the achievement of objectives directly related to the financial product (despite the December 2016 consultation paper). The lack of clarity and breadth of the power is extremely concerning for NIBA as is the risk of ASIC seeking to change existing general insurance remuneration arrangements by use of this power.

Should the objectives be limited to objectives directly related to the "issue or distribution" of the financial product?

Procedural requirements

ASIC must comply with two key procedural requirements prior to making an intervention order. These procedural requirements relate to consultation and the issuance of a public notice with respect to the intervention.

- ***Consultation*** - There are three consultation requirements that may be applicable to the making of an intervention order.
- ***Public notice of intervention orders*** - ASIC must issue a public notice in relation to the intervention and publish it on ASIC's website.

NIBA comments

The above is concerning to members despite assurances ASIC will always act properly. NIBA has referred above to a recent example (Life claims review) of where ASIC appears to have acted in a manner that is inconsistent with good regulatory practice.

It is concerning to NIBA that there is no minimum reasonable consultation period required of ASIC in making an order e.g Consultation can be 'deemed to be complied with' if ASIC simply provides a description of the order on its website - see s1022CE(2). This is contrary to natural justice and can cause significant damage to the market. If ASIC is wrong, it is all too late.

More detail should be required (not just a summary of an order) to allow affected persons to understand the ASIC approach. The PIP is intended to be a power of last resort and NIBA submits ASIC be required to provide disclosure on why alternative remedies were not otherwise appropriate.

There is no consultation required for amendment of orders or permanent orders. There should be for procedural fairness and natural justice.

ASIC's failure to consult does not invalidate its order and we do not believe this is appropriate where there is no court oversight. Better qualification is required e.g where ASIC reasonably forms the view that there is a risk of significantly increasing the significant consumer detriment if consultation were to occur.

Notice to the person the subject of the order should always be required.

Obligations associated with intervention orders

There are three obligations associated with intervention orders:

- a person must not to engage in conduct that is contrary to the order.

- where a person is served with an intervention order, the person must take reasonable steps to ensure that other persons who engage in conduct to which the order applies are aware of the order. This obligation is not necessary where an intervention order is made by legislative instrument.
- a person must notify their customers of an intervention order in certain circumstances. These circumstances are where: an intervention order has been made in relation to a product; and, the person has dealt in, or provided financial advice in relation to, the product with respect to consumers. In these circumstances, ASIC may require the person to notify those customers of the terms of the intervention order and any other matters that may be prescribed in the regulations.

The notice ASIC provides to the person may specify the way in which the person is to notify their customers. If the notice is a legislative instrument, the notice must also be a legislative instrument. If the notice is not a legislative instrument, a person does not need comply with the notice if they are not aware, and could not reasonably be aware, of the notice.

NIBA comments

Lack of compliance certainty around reasonable steps and the form of notification ASIC may require.

A reasonable steps qualification should also be included regarding provision of notices to take account of the fact contact may not be possible e.g address contact details have changed.

What are the consequences of contravening the new power?

The consequences of breaching the new provisions fall into two main categories. These are:

- liability to the state through civil penalty proceedings or criminal prosecution; and
- liability to persons suffering loss or damage through civil action.

NIBA comments

Given the lack of clarity and subjectivity of compliance the above consequences are concerning to members. This is likely to either result in a reduction in services due to the risks (reducing competition) or create overcompliance and ultimately, additional costs for consumers for little obvious added benefit.

We look forward to an indication of when draft guidance will be made available from ASIC for comment on the above significant matters.

What review powers are proposed in relation to ASIC PIP power to give industry comfort ASIC will apply this power properly as a last resort?

CONCLUSION

NIBA would be pleased to have the opportunity to discuss these matters in further detail, and to explain our concerns regarding the increasing complexity of legislative and regulatory intervention in relation to life and general insurance.

Dallas Booth
Chief Executive Officer

