Life Insurance Code of Practice

Second consultation draft

Financial Ombudsman Service Australia Submission

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Executive summary

The Financial Ombudsman Service (FOS) Australia[1] is an ASIC-approved independent external dispute resolution (EDR) scheme that covers disputes across the financial sector.[2]

As well as its role in dispute resolution, FOS has responsibilities to identify and resolve systemic issues and obligations to make certain reports to ASIC. We also provide secretariat services to code monitoring and compliance committees for four industry codes of practice.[3]

FOS considers that there should be a code of practice for life insurance (Code) to cover all services provided by life insurers, including insurance under superannuation group insurance policies. We strongly support efforts being made to develop the Code and welcome the opportunity to comment on the second consultation draft of the Code released by the Financial Services Council (Draft).

In our experience to meet the expectations of all stakeholders, a code of practice needs to be framed against a set of guiding principles, including:

The scope of the Code

The code should cover all services provide by life insurers, including group life insurance through superannuation.

It should also commit code subscribers to responsibility for the actions and conduct of their employees, agents and subcontractors who act on behalf of a life insurer in its engagement with a consumer.

In our experience codes of practice that have exclusions from cover and scope are less clear and can add confusion and complexity for consumers in their ability to access and understand how the code applies to them.

Customer centric focus

The code should set good industry practice consistent with community and stakeholder expectations. In particular, clear timelines should be set for the handling of claims and consumer complaints. The standards should also clearly address:

- Any concerns about the relevance and frequency of requests for information from those insured
- The review, application and interpretation of medical definitions and mental illness exclusions within policies and

[1] Information about FOS is set out in full on our website at www.fos.org.au. The Appendix to this document summarises key points.
[2] FOS is approved by ASIC under its Regulatory Guide 139 *Approval and Oversight of External Dispute Resolution Schemes*.
[3] See the Appendix for more detail.

- A single uniform approach to the cancellation of policies for non-payment of premium.

Accessibility

The Code should use plain English, speak to the consumer and simply and concisely state the standard that will apply, how the Code Subscriber will meet that standard in practice and what happens if it does not.

Fairness

The code should commence each section with a commitment to fair service and treatment of customers throughout the life cycle of the insurance product.

Openness/Transparency

The code should commit code subscribers to transparency of decision-making and conduct at all stages of the life insurance process, from sales and marketing to claims and complaints handling.

It is also important that the Code have clarity of reporting obligations by code subscribers about their compliance with code standards.

Accountability

Finally the Code should contain a clear governance framework for oversight and monitoring of enforcement of the Code's standards and the transparency and accountability of Code Subscribers for compliance with those standards.

In our recent submission to the Inquiry into the Scrutiny of Financial Advice conducted by the Senate Economics References Committee[4], we also explained our views on:

- how the Code should be designed
- what areas the Code should cover
- how the Code should address definitions in insurance policies and
- the scope for the Code to improve consumer protection through remediation.

We acknowledge the value of work done to date and seek to contribute further to this work by suggesting improvements to the Draft through this submission[5]. The submission focusses on these areas:

[4] FOS submission to the Inquiry by the Senate Economics References Committee into the Scrutiny of Financial Advice, April 2016.
[5] This submission has been prepared by the Office of the Chief Ombudsman and does not necessarily represent the views of the Board of FOS. It draws on the experience of FOS and its predecessor schemes in the resolution of disputes about financial services.

Guiding principles

Section 3 explains why the Code should include guiding principles and how they could be included.

Medical definitions

Section 4 suggests changes designed to:

- make medical definitions in life insurance policies easier for consumers to understand
- ensure that a single update mechanism for medical definitions is used consistently across the industry and
- provide for updates of medical definitions to apply fairly.

Cancellation of policies

Section 5 suggests the Code:

- commits subscribers to complying with section 210 of the *Life Insurance Act 1995* and
- requires use of a standard form for any notice of cancellation of a life insurance policy due to non-payment of premiums.

Standards

Section 6 highlights the need for the Code to set standards higher than, or at least as high as, current legal and regulatory standards. Suggestions to make the Code more consumer-friendly are also made.

Independent reviews

Section 7 suggests changes to:

- require the first independent review of the Code to be conducted soon after it commences and
- provide for limited independent reviews, to address concerns about particular provisions rather than the entire Code.

Monitoring, enforcement and sanctions

Section 8 suggests changes to strengthen provisions for sanctions and the responsibilities of subscribers and the Life Code Compliance Committee.

Remediation

Section 9 explains the need for the Code to take into account, and be consistent with, the regulatory guidance on remediation programs that ASIC is expected to release shortly.

Timeframes

Section 10 suggests a review to ensure timeframes in the Code will operate fairly and provide for claims to be handled efficiently.

Omissions

Section 11 suggests a review to identify and address any omissions from the Draft. It also provides examples of omissions**.**

Drafting

Section 12 suggests that the wording and structure of the Code be simplified.

Please contact FOS if you would like us to clarify any aspect of this submission or provide further information.

When a revised draft of the Code is produced, we would be happy to provide feedback on that draft.

1 Life Insurance Reforms

The central theme of our submissions to the Financial System Inquiry was that the inquiry's recommendations should encourage and support consumer trust and confidence in the financial system, the financial services providers and individual consumers deal with and the products and services they use.

We reiterated this view in our submission to the Senate Committee Inquiry into the Scrutiny of Financial Advice. We also referred to changes in the financial sector supporting a move towards a more integrated approach to consumer protection regulation rather than one based on regulating distinct activities.[6]

The Financial System Inquiry in its final report stated that the key to building consumer confidence and trust is the fair treatment of consumers by financial services providers and a broadening of the regulatory framework is need to focus beyond the point of sale. The final report concluded that 'alignment needs to start at the point of product design, and then be strengthened through distribution and advice'.[7]

We consider that the improvements to the code need to be considered in the context of reforms that should cover all stages from product development to sales and distribution. We also note the importance of current practice standards that apply in relation to advice on life insurance products, such as the Financial Planning Association of Australia's Code of Professional Practice and its 'Member Guidance Series' on life insurance advice.

In the context of life insurance, the duty to act in utmost good faith applies. This provides a strong base for life insurance reforms, which in our view should focus on ensuring fair treatment of consumers in all facets of product design, service, conduct, claims handling, complaints and remediation.

Our submission on the current draft of the life insurance code of practice is focused on ensuring fairness in consumer outcomes as a key underpinning of consumer trust in financial services.

2 Important role for Code to play

We support the development of the Code, including robust and transparent governance arrangements. Through a code, financial services providers can make commitments to consumers over and above requirements imposed by law.

When deciding disputes, FOS is required to have regard to factors including applicable industry codes and good industry practice.

Life insurers should put the interests of consumers first in a way that keeps pace with consumer needs and expectations, which continue to change, and may change

[6] See our Submission to the Interim Report of the Financial System Inquiry, August 2014, on page 8.
[7] See Financial System Inquiry Final Report, November 2014, on page 193.

rapidly. This includes meeting standards of good practice as well as meeting all relevant minimum legal requirements.

It is our experience that the majority of life insurance disputes concern claims handling, relating to matters including denials of claims, delays, and requests for information. We consider that a code could assist in ensuring good practice is adopted across the industry in crucial areas such as:

- the timeliness, fairness and transparency of claims handling
- decisions by life insurers to deny claims or to avoid or cancel policies – for example, to cancel policies due to non-payment of premiums
- requests for information and medical evidence and
- mechanisms to ensure medical definitions keep up to date with diagnostic practice.

3 Life insurance disputes considered by FOS

3.1 Life insurance members of FOS

FOS had some 5,540 licensees and 8,036 authorised credit representatives as members as at 30 June 2016. Our records for 2015-16 indicate that 33 of our members were life insurers and 44 were life insurance brokers[8].

We note that many of our financial advisory members provide life insurance and risk advice to their clients, either as advice related to stand alone policies or as advice on group, industry or retail superannuation products.

3.2 Life insurance disputes accepted in 2015-16[9]

FOS accepted a total of 20,298 disputes across our whole jurisdiction in 2015-16. We accepted 1,095 life insurance disputes in 2015-16. Denial of claims was the most common issue in life insurance disputes referred to FOS in 2015-16. This was the primary issue in 26% of the disputes.

Of the 1,095 life insurance disputes accepted in 2015-16, 55% related to income stream risk products, 42% related to non-income stream risk products and the classification of 3% was not determined as at 30 June 2016. Income stream risk typically involves income protection insurance products and non-income stream risk products are typically paid on death, total and permanent disability or critical illness.

[8] This information is based on how the financial services providers have described their business to us.
[9] More detailed information, including explanations of terms used, is provided in our Annual Review 2015-16 on pages 90 to 94.

4 Guiding principles

Ideally, a code should include guiding principles that life insurers need to observe to ensure they treat consumers fairly and consistently through the whole product life cycle. Principles in a code can be applied to take into account changes in practice, technology and other developments such as those that may impact on the interpretation of policy definitions, terms and conditions. This allows a code of practice in theory to be more flexible and agile than legislation or case law.

Section 1.5 of the Draft lists several qualities and states that they are principles that apply to products and services covered by the Code. In our view, this provision does not adequately state guiding principles or indicate how they apply in particular situations or to particular sections of the Code.

We suggest that broadly worded guiding principles be inserted at the start of each section of the Code from section 2 to section 14. These principles would state the key obligations imposed in each section. Examples of the type of wording that could be inserted are:

- In section 5 –

  We commit to processing your application for insurance in a fair, reasonable, transparent and timely manner.

- In section 9 -

  If you make a complaint to us, we commit to handling the complaint fairly, with respect and empathy and in a timely, transparent manner.

5 Medical definitions

FOS explained its views on how the Code should provide for medical definitions in life insurance policies in a submission to the Senate Inquiry into the Scrutiny of Financial Advice made in April 2016[10]. We consider that sections 3.2 and 3.3 of the Draft should be revised to address matters discussed in our April 2016 submission. Below, the recommended revisions are outlined and further suggestions are made.

5.1 Requirements for definitions

The Code provisions dealing with medical definitions should help to ensure consumers understand the coverage of life insurance policies. Our suggestions to strengthen these provisions are:

- The Code should require definitions to be expressed as clearly and simply as possible, with the use of technical language kept to a minimum.

[10] FOS submission to the Inquiry by the Senate Economics References Committee into the Scrutiny of Financial Advice, April 2016.

- For key illnesses or trauma, the Code should require adoption of standard definitions or default definitions.
- When a policy uses a commonly understood term, such as ‘major heart attack’, ‘cancer’ or ‘stroke’, the Code could require the policy to give the term its ordinary meaning or one that is consistent with current medical practice and clinical diagnostic tests.

5.2 Update mechanisms

The Draft acknowledges the need to keep medical definitions up to date. However, it does not ensure that update practices are consistent across the industry. As drafted, section 3.2 would permit each Code subscriber to have its own system to update medical definitions.

In our view, a single update mechanism should operate industry-wide and the Code should require subscribers to use this mechanism. There should be a consistent industry standard on the timing, evidence of and approach to updating to keep pace with current practices, medical or diagnostic developments or other changes affecting matters such as technology or community expectations.

5.3 Application of updates

There should be a commitment that consumers receive the benefit of any updated definition for all claims made from the date of the update. Default definitions could ensure that no consumer will be worse off due to an update.

Updates of definitions should not reduce benefits under an insurance policy. If an update reduces the likelihood of claims, the version of the definition most favourable for the consumer should apply. Section 3.3 should reflect this approach.

In the scenario referred to in the second sentence of section 3.3 (where a cost increase is anticipated due to an increased likelihood of claims) the Code should require the subscriber to seek consent to the change.

6 Cancellation of policies

During the first round of consultation for the Code, FOS explained its concerns about non-compliance with section 210 of the *Life Insurance Act 1995*. To improve compliance, we recommended that the industry moves to using a standard form for any cancellation of a life insurance policy due to non-payment of premiums. Section 6.7, as drafted, does not address our concerns.

Our view is that:

- The Code should state that a subscriber will not cancel a life insurance policy due to non-payment of premiums unless the requirements of section 210 are met.

- There should be a standard form to provide notice of such a cancellation. This form, would could be set out in an appendix to the Code, should specify in clear terms –
    - the amount of the premium
    - the date when the premium became or becomes payable and
    - the consequences of non-payment.
- The Code should require the standard form to be used to meet the notice requirements imposed by section 210.

7 Standards

7.1 Legal and regulatory standards

The Code should not set any standards at a lower level than applicable law or regulatory guidance. Law or regulation would prevail over any lower standards.[11] Another crucial factor is that including lower standards could undermine the status of the Code as a document setting standards of good industry practice.

Some provisions in the Draft might set standards that are not sufficiently high. Section 3.1 is one example. The disclosure requirements in paragraphs c) and d) appear to be less exacting than the *Corporations Act 2001*.

We suggest a thorough review of the Code to amend any provisions that may set standards lower than current legal and regulatory standards.

7.2 Helping consumers

Some provisions do not set standards in consumer-friendly terms in our view. This could be addressed when the review recommended above is conducted.

Section 3.8, which deals with product disclosure statements, is an example illustrating this issue. It refers only to providing documents online. It does not indicate that a consumer will be given a hard copy document on request. Section 3.8 uses the abbreviation 'PDS' without explaining its meaning and we note that section 15 does not define 'PDS' or 'product disclosure statement'.

8 Independent reviews

8.1 First review

Section 12.2 of the Draft requires independent reviews to be commissioned 'as appropriate, no less than every three years'. We consider that a shorter timeframe should apply for the first independent review to enable any initial problems to be

[11] See section 2.18 in the Draft.

identified and addressed quickly. For example, the Code could require the first review to be conducted within eighteen months after the Code commences.

8.2 Limited reviews

Section 12.2 could provide greater flexibility. It also could allow the Life Code Compliance Committee (Life CCC) to recommend a limited review covering particular provisions of the Code (as an alternative to a full review of the Code) if the Life CCC believes those provisions are not meeting their objectives.

9 Monitoring, enforcement and sanctions

Based on our knowledge of the arrangements to monitor compliance with industry codes of practice that currently operate in the financial services sector, we suggest changes to section 13 of the Draft.

9.1 Responsibility of subscribers

We suggest that section 13.5 be reviewed. It may need to include a reference to Third Party Service Providers before 'fail to comply'.

9.2 Responsibility of Life CCC

For completeness, we suggest items be added to the list in section 13.8 requiring the Life CCC to also:

- obtain an annual report on Code compliance from each subscriber and
- undertake activities to ensure subscribers comply with the Code.

We consider that section 13.8e) should be altered to reflect that 'corrective measures' are imposed by the Life CCC rather than agreed. We suggest that the first phrase in the provision should be changed to 'impose corrective measures to be implemented by us within reasonable and relevant timeframes'. To accord with this change, we also suggest deleting 'or if we cannot agree on corrective measures' from section 13.10.

9.3 Sanctions

In our view, 13.13 is not an exhaustive list of the factors the Life CCC should consider when determining whether to impose sanctions. We suggest these factors be added to the list:

- impacts on consumers
- recalcitrant conduct and
- risks of ongoing breaches.

Section 13.16 may need to also provide for the Life CCC to advise the FSC Board of any non-compliance with sanctions. The FSC Board is responsible for disciplinary action for such non-compliance.

10 Remediation

Our submission to the Senate Inquiry into the Scrutiny of Financial Advice in April 2016[12] referred in detail to developments in the regulation of remediation programs. It also highlighted the scope for the Code to improve consumer protection through remediation.

ASIC is expected to release a Regulatory Guide on remediation programs by September 2016. We anticipate that the ASIC guidance will apply to life insurance as well as other financial services and that the Code will need to accord with the guidance.

We suggest that, when ASIC releases its new Regulatory Guide, the Draft is reviewed to ensure it takes into account, and is consistent with, the guidance. Information about the guidance proposed is already available on ASIC's website.[13]

11 Timeframes

11.1 Commencement of timeframes

Certain timeframes specified in the Draft may not commence until a consumer has encountered long delays. For example, time does not start to run against a subscriber under section 5.4, 5.12 or 8.14 until they obtain all the information they need to make a decision, even if the consumer has supplied information promptly. We suggest a review of provisions for commencement of timeframes to ensure they provide for time to start running against subscribers in a way that is fair to consumers.

11.2 Exceptional circumstances

The timeframes specified in section 8.15 and 8.16 refer to 'exceptional circumstances', which are given a broad definition in section 15. We consider that paragraph b) of this definition should be reviewed to ensure total and permanent disability claims are handled efficiently.

When exceptional circumstances exist, section 8.16 does not impose any timeframe. We note that section 8.15 imposes a 12 month timeframe in these circumstances and are concerned that section 8.16, as drafted, could produce unfair outcomes. For this reason, we suggest section 8.16 be reviewed.

[12] FOS submission to the Inquiry by the Senate Economics References Committee into the Scrutiny of Financial Advice, April 2016.
[13] See Consultation Paper 247 on **www.asic.gov.au**.

12 Omissions

This section discusses omissions from the Draft that we have noted. We have not attempted to identify every omission. We suggest the Draft be reviewed to ensure it is complete, covering all key obligations.

12.1 Detailed provisions

The Draft addresses some areas in detail, but without fully stating the obligations of subscribers.

One example is section 5, which is a long provision titled ‘When you buy insurance’. Although it includes considerable detail, it does not state that a subscriber should allow a consumer applying for insurance to check their application and information supplied in connection with the application. The consumer should be given an opportunity to check and, if necessary, correct the application and information. This comment applies to section 5.19, which deals with information provided electronically, as well as other parts of section 5 dealing with provision of information in more general terms.

To ensure that certain provisions setting out details are complete, statements in broader terms could be added to them. Examples of broad statements that could be included in particular sections are provided below.

- Section 8.10

  Where a subscriber requires an independent medical examination, the Code could state that the subscriber will act respectfully, especially in a claim for a terminal illness.

- Section 8.11

  Section 8.11 could include statements along these lines:

  - We will undertake interviews and surveillance in a fair, reasonable, respectful and accountable way.
  - Interviewers and surveillance officers will not engage in conduct likely to embarrass, bully, intrude or intimidate others.

- Section 8.13

  Section 8.13 could also state that claims decisions and payments of benefits will be timely, fair, reasonable and transparent.

12.2 Lists

Several provisions in the Draft contain incomplete lists of obligations. Examples are noted below.

- Section 15 – definition of ‘significant breach’

The factors listed in this definition should also include the impact on consumers, and the number of consumers affected.

- Section 4.3

The ‘sales philosophy’ mentioned in section 4.3 should also cover the disclosure obligations on the consumer, dealing with matters such as pre-existing conditions and prior claims.

- Section 4.7

The annual notice referred to in section 4.7f) should also include the amount of premium paid.

This could be addressed by reviewing lists in the Draft and making additions where necessary. In some cases a solution could be to include a category expressed in more general terms at the end of an incomplete list.

13 Drafting

It is essential to draft the Code as clearly and simply as possible. Both the wording and the structure of the Draft could be simplified.

Specific examples of unclear wording include:

- Section 3.1e) – which requires action ‘regularly’, but should set a precise timeframe using words such as ‘every three years’
- Section 8.10c) – ‘we will avoid requesting more than one independent medical examination for the same specialty within six months where possible’
- References to ‘non-disclosure investigation’ in section 8.19 and ‘extraordinary travel costs’ in section 8.10a) which are not explained in those provisions or defined in section 15.

The indirect language in some provisions makes them unnecessarily complicated. Section 8.10c) referred to above is one example. It could use more direct language such as ‘we will only request more than one independent medical examination for the same specialty within six months where necessary’.

The wording of certain provisions makes the obligations of subscribers unclear in our opinion. An example is section 6.5. We consider that ‘or your distributor or financial adviser/planner’ should be deleted from that provision to make clear that the subscriber is responsible for providing information about options available.

If strong guiding principles are added to the Draft, individual provisions of the Code will not need to repeatedly use terms such as ‘fair’ and ‘reasonable’. To provide an example, we refer to sections 5.17 and 5.18. Both provisions refer to decisions and should in our view require the decisions to be fair and reasonable.

If a guiding principle for section 5 were to require decisions to be fair and reasonable, individual provisions like sections 5.17 and 5.18 would not need to again specify the requirement. For this reason, including the guiding principles suggested should allow the drafting to be more streamlined.

We note that the following sections appear to contain drafting errors:

- Section 9.12 – Should the opening words ‘Where possible’ be deleted?
- Section 10.9c) – Wording such as ‘the investigator does not’ has been omitted, changing the meaning of the provision.

Appendix - About FOS

FOS was formed in 2008 from the merger of three predecessor schemes organised largely along industry sector lines. The original participants were:

- the Banking and Financial Services Ombudsman
- the Financial Industry Complaints Service, and
- the Insurance Ombudsman Service.

On 1 January 2009, two other schemes joined FOS, namely:

- the Credit Union Dispute Resolution Centre, and
- Insurance Brokers Disputes Ltd.

FOS is an ASIC-approved independent EDR scheme that covers disputes across the financial sector. Our service is free to consumers and is funded through a combination of levies and case fees paid by our members, which are financial services providers.

Our operations are governed by our Terms of Reference that form a contract with our members. The Terms of Reference are available on our website.

FOS and its predecessor schemes have over 20 years' experience in providing dispute resolution services in the financial services sector. FOS provides services to resolve disputes between member financial services providers and consumers, including certain small businesses, about financial services such as:

- banking
- credit
- loans
- general insurance
- life insurance
- financial planning
- investments
- stock broking
- managed funds, and
- pooled superannuation trusts.

As well as its functions in relation to dispute resolution, FOS has responsibilities to identify and resolve systemic issues and obligations to make certain reports to ASIC.

FOS also provides code monitoring, administration and secretariat services to committees that monitor financial services providers' compliance with these industry codes of practice:

- the Code of Banking Practice
- the Customer Owned Banking Code of Practice
- the General Insurance Code of Practice and
- the Insurance Brokers Code of Practice.

FOS is governed by a board with an independent chair and:

- four ‘industry directors’ appointed based on their expertise in and knowledge of the financial services industry, independence and capacity and willingness to consult with the industry, and
- four ‘consumer directors’ appointed based on their expertise in consumer affairs, knowledge of issues pertaining to the industry, independence and capacity and willingness to consult with consumer organisations.