



### **REPORT 587**

# The sale of direct life insurance

August 2018

### **About this report**

This report summarises the findings and recommendations from ASIC's review of the sale of direct life insurance products in Australia, including term life, accidental death, trauma, total and permanent disability (TPD) and income protection insurance.

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- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
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**Information sheets**: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

**Reports**: describe ASIC compliance or relief activity or the results of a research project.

### **Disclaimer**

This report does not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.

Examples in this report are purely for illustration; they are not exhaustive and are not intended to impose or imply particular rules or requirements.

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## **Executive summary**

- Life insurance plays a crucial role in helping consumers manage unexpected events and protect themselves and their families against financial difficulties. Buying life insurance directly—that is, without getting personal advice from a financial adviser or buying through a group arrangement like superannuation—can be a convenient way to buy life insurance.
- Direct life insurance is sold to consumers by insurers or their sales partners, by outbound telemarketing, inbound phone calls from consumers, online or face to face (e.g. through bank branches). These products are sold with general advice (meaning a consumer's individual circumstances are not considered), or with no advice (meaning only factual information is given).
- In 2016, ASIC's review of life insurance claims handling showed higher declined claims for life insurance bought through the direct sales channel than for retail and group insurance: see Report 498 Life insurance claims:

  An industry review (REP 498).
- Following the release of REP 498, we wanted to review how life insurance products in the direct channel are designed and sold, and whether this might increase the likelihood of policies lapsing or consumers later having their claims declined.

### Scope of ASIC's review

During 2017–18, we conducted a multi-stage review of the sale of direct life insurance, including term life, accidental death, trauma, total and permanent disability (TPD) and income protection insurance.

Note: We did not review consumer credit insurance or funeral insurance due to other completed or ongoing ASIC work on those products (see paragraph 89 of the report).

- Two types of firms were included in our review, comprising a total of 11 firms, including:
  - (a) six insurers selling directly to consumers; and
  - (b) three distributors selling on behalf of two insurers.

Note: Our call review findings refer to eight firms, comprising three distributors and five insurers selling directly (one insurer selling directly exited the direct life insurance market during the early stages of our review). Our sales, claims and lapse data was collected at an insurer level, and these findings refer to the eight insurers in our review. See Appendix 1 for the names of the firms included in our review.

Table 1 summarises the different elements of our review. For further details of our methodology, see Appendix 1 of the report.

Table 1: What we did in our review

Element	Description
Review of sales	We completed two sales call reviews with a focus on whether sales practices may contribute to poor consumer outcomes.  In our first call review, we listened to 151 sales calls from 2010–16 where the policy had later lapsed or there had
	been a declined claim, to assess whether the sales call may have contributed to this outcome.
	<ul> <li>In our second call review, we listened to 393 sales calls from July and August 2017, after the new Life Code of Practice (the Code) had come into force, to assess more recent practice.</li> </ul>
	We also engaged Strategic Insight, a research firm, to conduct a review of firms' online sales processes.
Data analysis	We obtained data from firms relating to:
	<ul> <li>trends for in-force policies and new sales;</li> </ul>
	<ul> <li>claim numbers and outcomes; and</li> </ul>
	<ul> <li>lapse rates including cooling-off cancellations.</li> </ul>
Review of	For each of the firms, we reviewed:
products, policies and	<ul> <li>the features and limitations of their direct life insurance products;</li> </ul>
procedures	scripts and training materials;
	<ul> <li>quality assurance processes and actual assessments conducted; and</li> </ul>
	<ul> <li>targets, incentives and performance management frameworks.</li> </ul>
Culture review	We reviewed the sales culture of a subset of the firms in our review to help us understand what we were seeing and why.
Consumer	We engaged Susan Bell Research to conduct quantitative
research	and qualitative research with consumers who had recently bought direct life insurance.
	Note: See Report 588 Consumers' experiences with the sale of direct life insurance (REP 588).

# **Summary of findings**

8 Our review identified several areas of concern in the sale of direct life insurance.

#### Consumer outcomes and sales conduct

# Finding 1: Outcomes for consumers who buy direct life insurance are often poor

- A well-functioning direct life insurance market should see consumers buying life insurance products that are right for them, are affordable in the long term, and that they can rely on when they need to claim. Consumer outcomes in our review indicate that the needs of a significant number of consumers in this market are not being met.
- Life insurance is a product designed to be held longer term, yet we saw a high rate of consumers cancelling their cover during the cooling-off period (i.e. cancelling without cost within a set period of time after purchase of at least two weeks) or letting policies lapse.
- From 2012–17, cooling-off cancellations and short-term lapse rates for direct life insurance were very high:
  - (a) one in five of all policies taken out were cancelled in the cooling-off period, which may indicate that consumers immediately realised they had made a bad decision or had been pressured into buying a policy they did not need;
  - (b) a quarter of all policies that remained in force beyond the cooling-off period lapsed within 12 months; and
  - (c) almost half of all policies held beyond the cooling-off period lapsed within three years.
- Claim outcomes for direct life insurance were also poor, relative to life insurance sold through other channels. Data on life insurance claims for the period 1 January 2017 to 30 June 2017 published by the Australian Prudential Regulation Authority (APRA) and ASIC found that 93% of finalised claims across all channels (advised, group and direct) were admitted, while for the direct channel this was only 84%.

Note: See APRA, <u>Response to submissions: Life insurance—Public reporting of claims information—Update on progress</u> (24 May 2018), pp. 13, 38. Admitted claims exclude funeral insurance and consumer credit insurance as these products were not included in our review and are generally not sold through advised or group channels.

- Data collected from the firms in our review for 2014–17 showed an even lower rate of admitted claims, with 79% of finalised claims admitted during this period.
- Because withdrawn claims can indicate that a policy does not cover what a consumer expected, we analysed the data to show the impact of withdrawn claims. We found that 27% of reported claims were withdrawn, 15% were declined, and 58% admitted.

- High lapses and unsuccessful claims indicate that consumers are frequently not able to make informed decisions when buying life insurance direct and are at high risk of buying cover that they do not want or that is not right for them.
- Our consumer research supports the concern that buying life insurance direct can be a difficult experience for consumers and that consumers often have limited understanding. Most respondents knew little or nothing about life insurance before they bought the product, and two thirds had not undertaken any research to inform their decision.
- While four in five respondents felt very or fairly confident that they had bought the right policy, 66% did not have a clear understanding of what exclusions applied to their policy, and 37% believed that the cost of their cover would stay the same each year.
- Some respondents found the process overwhelming and were unclear about what policy they had bought, but not all consumers had a difficult experience. Some researched extensively and used both the online and phone sales channel to buy the cover they felt was right for them.

# Finding 2: There is a clear link between sales conduct and poor consumer outcomes

- Inappropriate sales practices were linked to short-term lapses and declined claims. We reviewed 151 sales calls from 2010–16 that had resulted in a poor consumer outcome and observed sales conduct that appeared to contribute to the outcome in:
  - (a) 35% of the sales calls where a claim was later declined; and
  - (b) 63% of the calls where a policy later lapsed (within three years).
- The conduct that contributed to these outcomes included pressure selling, inadequate explanations of future cost and product exclusions, promotional gifts, and tactics to reduce informed decision-making.

Finding 3: Firms engaged in sales conduct that is likely to lead to consumers buying a product they do not want or cannot afford, or that does not meet their needs

- We listened to a further 393 sales calls from July and August 2017, after the Life Insurance Code of Practice (Code) issued by the Financial Services Council (FSC) had come into force. This review was undertaken to identify both improvements in conduct, and ongoing practices that increase the risk of poor consumer outcomes.
- For many firms, conduct had improved, and the introduction of the Code by the FSC appears to have played a role in improving sales standards, particularly where it sets clear and specific expectations. However, we identified ongoing practices that create the risk of poor consumer outcomes.

- All the firms in our review failed to provide adequate information about important aspects of the cover they sold. For example:
  - (a) four firms provided inadequate explanations of exclusions for preexisting medical conditions (see paragraphs 340–347 of the report), which can lead to consumers buying cover that does not meet their needs and later having claims declined; and
  - (b) none of the firms consistently provided clear explanations of the likely future cost of their policy, creating the risk that policies lapse because consumers cannot afford rising future premiums.
- We also saw pressure selling techniques used by four of the firms in our review, including using deferred payments or the cooling-off period to push a sale, refusing to send out paperwork unless a consumer committed to buy, and inappropriate or excessive objection handling. This will result in consumers feeling pressured to buy a policy that they do not want or cannot afford.
- Six of the eight firms in our review engaged in 'downgrading' to close a sale—that is, offering a more limited life insurance policy when a consumer is declined for their original choice of cover. Downgrading often happened without a clear warning about the limitations or exclusions of the downgraded policy, increasing the risk that consumers buy cover they do not understand and that does not meet their needs.
- Some firms engaged in other conduct that reduced informed decision making—for example, by bundling cover into a quote or selecting a cover amount without asking the consumer.
- We expect the industry, through a revised Code, to raise standards: see paragraphs 65–66 of the report.

# Finding 4: Overall industry conduct had improved over the review period, with outbound sales associated with ongoing conduct issues

- Poor conduct, including pressure selling, was more prevalent in the older calls we listened to as part of our first call review. This appears to be, in part, due to a move away from outbound sales models.
- Outbound sales include unsolicited telemarketing calls, or situations where consumers would not expect a sales call. For example, this might be because they entered a competition or completed a survey, or if they are an existing customer of a non-life insurance business, where they unknowingly agreed to terms and conditions that signed them up to receive marketing calls about life insurance.
- In our first call review, all the firms were engaged in outbound sales. We welcome the fact that by mid-2017 three firms had stopped this practice, and a fourth firm had predominantly stopped outbound sales. The most

concerning sales conduct we observed, particularly the use of pressure selling, was mainly by firms still engaged in outbound sales.

- This is consistent with our consumer research, where consumers who bought a policy during an outbound sales call were more likely to have felt pressure to buy and were more likely to have been influenced by the sales person in their decision on type and level of cover.
- Consumers who bought life insurance in response to outbound sales calls were more likely to have been told that they did not need to get a medical examination and that they did not need to answer any questions about their medical history. This suggests that they were offered products with preexisting condition exclusions—but these consumers were also less likely to be aware of any exclusions for their policy.
- We do not consider that selling a product as complex as life insurance on an outbound basis is conducive to consumers making informed decisions. We are proposing to restrict outbound phone sales of direct life insurance: see paragraph 78 of the report.

### Product design

Finding 5: Some products or product features provided little value to consumers, while others were difficult to understand and therefore may not perform as expected

- Guaranteed acceptance products, such as accidental death insurance or products with pre-existing condition exclusions, have a lower likelihood of consumers being eligible to claim due to the substantial limitations and exclusions applied to these products.
- We are particularly concerned about the value of accidental death insurance, and data shows that this product offers little benefit to consumers: the claims ratio for the 2015–17 financial years was 16.1%. This means that for every \$1 of premium paid by consumers, only 16 cents was paid in claims by insurers.
- More generally, premium features were complex, and in some cases, firms relied on consumers identifying and opting out of benefits that could result in poor value. For example, automatic indexation is intended to increase cover in line with rising incomes and cost of living. However, some firms applied automatic indexation to income protection policies with claim limits (e.g. 75% of income after tax) where the increases could lead to the consumer paying for more cover than they could ever claim.
- Some product features appeared to be designed more to promote and differentiate products than to meet a genuine consumer need. For example, an age benefit such as 'guaranteed payout' is unlikely to perform as expected when it has stepped premiums which make the cover unaffordable for many consumers before the payout age is reached.

Unless firms can demonstrate that accidental death insurance can provide a benefit to consumers, we expect them to stop selling this product. If they do not, we will consider the need for more formal action in the future: see paragraph 79 of the report.

### Training and scripts, quality assurance and incentives

Our review highlighted how business practices can drive the sales conduct issues we observed.

# Finding 6: Training and scripts did not always set clear and professional standards for sales conduct

- Some firms' training and scripts prescribed sales practices that we identified in our call review as concerning, such as inappropriate objection handling. In some cases, expectations on appropriate sales conduct were not clearly articulated or appeared conflicted. For example, while sales staff were told not to engage in pressure selling, they were also trained in objection handling and 'closing' techniques.
- Training on product knowledge was generally very thorough and comprehensive, and most firms' training covered key compliance requirements in detail. However, scripts sometimes failed to include clear guidance on effective disclosure about product exclusions, which likely contributed to some of the poor conduct we observed in our call review.
- Firms incorporated training on the treatment of vulnerable consumers—that is, people who may require more assistance to make an informed decision due to language difficulties, comprehension, financial limitations or other reasons. However, training did not always provide comprehensive guidance on how to identify these consumers and what practical steps sales staff should take to assist them.
- In general, we noted that scripts and training were balanced in favour of compliance and business risk rather than considering consumer outcomes.

  Training particularly failed to highlight the real-life consequences for consumers and their families from being sold life insurance that was not right for them. Firms must put the needs and challenges for consumers at the forefront of sales staff's minds.
- Under their Australian financial services (AFS) licence, firms must ensure that their representatives are adequately trained and competent to provide financial services. To ensure that firms are meeting this key obligation, training should address the findings on sales conduct in our report and must establish clear and professional standards for this conduct: see paragraph 71 of the report.

# Finding 7: Quality assurance frameworks were not always effectively designed to detect and address poor sales conduct

- Firms' quality assurance frameworks did not consistently test for behaviours that were likely to increase the risk of poor consumer outcomes and were not effective at detecting such conduct. When we compared the quality assurance assessments firms completed, against our own call reviews, we found that in 90% of cases (26 out of 29 assessments) firms did not identify the key issues we identified in our review.
- Some quality assurance frameworks had very low thresholds for passing assessments or did not strongly penalise failure, limiting the consequences for sales staff where inappropriate conduct was identified.
- While all firms took a risk-based approach to sampling, this did not always capture calls likely to pose the greatest risk to consumers but was often designed to minimise risks to the business. Sample sizes were sometimes so small that it was unlikely the firm could monitor conduct effectively.
- It was not always clear whether issues identified in assessments were followed up with consumers in a consistent and timely manner. We did see evidence of consistent feedback to the sales staff involved and corrections to underwriting, but it was less clear that consumers were always contacted to fix problems.
- In some cases, there was no evidence that firms took decisive action to remove sales staff who did not meet expected standards from phones or made changes to processes and procedures in response to issues identified by the quality assurance assessments.
- Under their AFS licence obligations, firms must do all things necessary to provide financial services efficiently, honestly and fairly. To ensure that firms are meeting this key obligation, we expect firms to significantly strengthen their quality assurance frameworks: see paragraph 71 of the report.

Finding 8: Conflicted incentive schemes were linked to inappropriate point-of-sale conduct, but changes being made in response to recent reforms should mitigate this risk and improve conduct

- Most firms had incentive schemes with features designed to drive sales, such as minimum sales targets, commission or bonuses based on the number or value of sales, and target-driven commission accelerators. These create conflicts of interest, as they encourage sales staff to put their own interest of closing a sale ahead of consumers' interests.
- Firms attempted to manage these conflicts of interest, for example, by using balanced scorecards, introducing quality assurance targets, and putting commission clawback in place. While these features should have some positive impact, we found that they were generally not sufficient to mitigate the risk from remuneration structures.

- We identified a link between incentive schemes and conduct at point of sale. With one exception, those firms with the incentive schemes that had the most significant conflicts of interest were also the firms who engaged in pressure selling and other practices where a sale was prioritised ahead of the needs of the consumer. We do not consider that heavily sales-driven incentive schemes support a professional culture.
- The Life Insurance Framework (LIF) reforms, which came into force on 1 January 2018, reduce conflicted remuneration in sales of life insurance. These provisions apply to sales of life insurance through the direct channel. We expect that the changes made by industry to comply with these reforms should reduce sales-driven behaviour and result in better consumer outcomes.
- Firms will need to remove conflicted remuneration schemes or comply with commission caps and put in place clawback arrangements over two years (i.e. they must hold back or recover any commissions paid to sales staff where policies lapse within two years of a sale). This will reduce instances of sales staff putting their own interests ahead of the consumer and promote lower lapse rates.

Finding 9: Our review of sales culture shows that there can often be a disconnect between firms' 'target culture' and what happens in practice

- We used a review of sales culture to help us understand what conduct we were seeing and why it was occurring.
- We asked firms for their 'target culture', by describing their values and desired consumer outcomes, and how these are embedded and measured. We then contrasted this with the 'observed sales culture' through our own assessment of processes and practices and behaviour by sales staff on calls.
- All firms had one or more corporate values that focused on the consumer. However, when it came to translating these values into concrete and measurable outcomes, many firms focused on fairly limited or short-term metrics, such as customer service measures. Given consumers' limited knowledge of life insurance and the 'long-tail' nature of the product, we do not consider that this effectively measures consumer outcomes. Concrete consumer outcomes, as measured by lapses or unsuccessful claims, did not feature prominently, if at all.
- The consumer perspective was not always embedded in processes and procedures in a consistent way. While some firm's processes demonstrated a clear consideration of their customers' needs, in other cases we found that the design of policies (e.g. sales scripts or incentive schemes) appeared to contradict the overarching objective of 'doing the right thing by consumers'.

- We found some examples of good practice and cultural alignment across firms. However, we found more instances of cultural disconnects or inconsistencies. For example:
  - (a) what happened in practice in the calls differed markedly from what the firm set out to do;
  - (b) tension between different business practices, including conflicts of interest, meant that firms could not consistently deliver good consumer outcomes; and
  - (c) there was a real difference between explicit messaging (e.g. in training materials) and implicit messages in other documentation.
- We also note that all firms could do more to ensure that consumer outcomes are considered in a consistent manner in all their processes and procedures. We recommend that all firms consider the cultural disconnects or misalignments we describe and how these examples may apply to their own business.

### **ASIC's expectations of industry**

- Despite the concerns highlighted by our review, we were encouraged to see that sales practices and product design improved over the period we reviewed. Some firms have moved away from riskier business models—such as outbound sales and reliance on products with exclusions for pre-existing conditions—and have taken active steps to improve conduct. Some firms showed greater professionalism in the sale of direct life insurance, whereas others fell short.
- The introduction of the Code by the FSC appears to have played a role in improving sales standards. However, significant improvements are still needed to reduce the risks of poor consumer outcomes and to consistently place the interests of consumers at the centre of the direct life insurance market, and to increase consumer trust in direct life products and how they are sold.
- The Government has also agreed to introduce reforms that will help to raise standards in this sector. In particular, the proposed product design and distribution obligations will require firms to identify clear target markets, design their products to meet these consumers' needs, and distribute them accordingly. Firms will also be obliged to conduct regular reviews of product performance. In acting to address the issues identified in this report, industry should assess their current products and distribution strategies with these future obligations in mind.

# Expectation 1: The Life Insurance Code of Practice needs to set higher standards and raise professionalism across industry

- Industry can respond promptly to the issues identified in this report by raising standards in the next iteration of the Code and increasing professionalism across the industry.
- We expect the revised Code to set rigorous standards to address our findings, including requiring insurers to:
  - (a) Provide adequate explanations of key exclusions and future cost—Firms should clearly explain these features and limitations as part of their sales calls. Firms should not rely on including this information in lengthy pre-recorded or verbatim disclosures. Pre-existing condition exclusions in particular should be clearly explained to the consumer, with practical examples to highlight the breadth of this exclusion.
  - (b) Stop pressure selling—The Code currently commits insurers to prevent pressure selling but does not articulate what pressure selling is. The Code must clearly define and prohibit pressure selling. This must include that firms stop using the cooling-off period and deferred payment arrangements to conclude sales and provide a written quote and policy information to consumers if requested. Firms must also have clear guidelines for staff to end a sales call the first time a consumer states that they do not want to proceed.
  - (c) Introduce a deferred sales model for downgrades—If a consumer is not eligible for a policy and the firm offers a downgraded option, they should provide a clear warning upfront about the product's extra restrictions or limitations. Firms should also provide the Product Disclosure Statement (PDS) and schedule a call back at a later date, after a set number of days have elapsed, rather than concluding the sale in the same call, so the consumer has time to consider whether the product meets their needs.
  - (d) Stop using techniques that frame consumers' choices—Firms must allow consumers to make their own choices about cover type and sum insured and must not engage in techniques that reduce informed decision making, such as bundling cover into a quote without seeking explicit consent from the consumer upfront.
  - (e) Establish a clear target market for limited value products and only sell these products where there is genuine consumer need—For example, the substantial limitations of accidental death insurance mean that it is unlikely to meet consumer needs. Firms should cease selling this product except where they can demonstrate that it provides value and meets a genuine consumer need. Firms should also review other product features and not include such benefits if they do not serve a clear purpose and offer value in terms of consumers managing risk.

- (f) Strengthen protections for vulnerable consumers—Firms should build on the existing provisions in the Code and set clearer expectations about how sales staff should behave when dealing with vulnerable consumers, including when it will be appropriate to end a call. Quality assurance frameworks should test whether sales staff identified and responded to vulnerable consumers.
- (g) Ensure that automatic cover increases do not exceed what the consumer can claim—Firms must ensure that automatic indexation increases do not result in the consumer paying for more cover than they could ever claim, for example, where the policy has a claim limit based on a proportion of the consumer's income.
- (h) Implement training and quality assurance frameworks that establish standards, monitor sales conduct, and resolve poor consumer outcomes— Firms must establish clear standards for sales conduct and establish quality assurance assessments that specifically test sales staff against the Code obligations. Assessments must be conducted within a short timeframe and firms must promptly contact the consumer if an assessment identifies issues with consumer need or understanding. The Code should mandate minimum timeframes for quality assurance processes.
- We expect all firms to do more to understand what leads to outcomes such as high declined and withdrawn claims and short-term lapses in their particular business. Firms should then take action to make necessary changes to sales or product design to address these issues, including but not limited to those identified in this report. This may involve taking action beyond just strengthening disclosure at the point of sale to improve outcomes. A focus on lowering lapse rates should not result in aggressive retention.
- Insurers who sell their product through distributors who hold their own AFS licence should ensure their agreements with these sales partners commit the distributor to meet relevant standards under the Code.
- We expect that firms selling direct life insurance will not wait for the Code to be updated but will review the findings and recommendations in this report and implement changes as required to improve consumer outcomes.
- While we did not cover sales of consumer credit insurance and funeral insurance as part of this review, consumers will be facing similar challenges when being sold those products. We expect firms selling consumer credit insurance, and in particular funeral insurance, to act on our findings and recommendations.

# Expectation 2: Firms must take action to ensure they are meeting their licensing obligations

- Firms must review their internal policies and procedures against the findings of our review to ensure they are sufficient to meet their obligations under their AFS licence, including their general obligations to:
  - (a) provide financial services efficiently, honestly and fairly;
  - (b) ensure that representatives are adequately trained and competent to provide financial services;
  - (c) ensure that representatives comply with financial services law; and
  - (d) have adequate arrangements in place for managing conflicts of interest.

### **ASIC's actions**

### ASIC action 1: Monitoring and publication of consumer outcomes

- Following the release of REP 498, APRA and ASIC have worked collaboratively to establish a public reporting regime for life insurance claims information with the aim of improving the accountability and performance of life insurers. We have published aggregate industry data already and propose to publish individual insurer data in the future to provide transparency about claim outcomes for consumers, including for direct life insurance.
- We will also collect data on a six-monthly basis on cooling-off cancellations and short-term lapses to test whether consumer outcomes improve. If outcomes do not improve, we will consider what further regulatory interventions will be necessary, using the full range of our powers.

### **ASIC** action 2: Remediation and enforcement action

- Remediation is already underway—Clearview has commenced refunding approximately \$1.5 million to 16,000 consumers.
- Where we saw the most concerning conduct, we are reviewing what further remediation is required by other firms to address consumer harm.
- Any firms who have engaged in the inappropriate sales conduct identified in this report must review past sales of direct life insurance and remediate consumers appropriately. This includes any firms selling direct life insurance who were not subject to this review.
- We are assessing the conduct of individual firms to determine whether enforcement action is required.

#### **ASIC** action 3: Outbound sales

We intend to restrict outbound sales calls for life and funeral insurance. We are considering what regulatory tools we will use to implement this reform. In the meantime, the small number of firms who are still engaged in outbound sales will need to move away from this practice.

### **ASIC** action 4: Accidental death insurance

We will monitor consumer outcomes for accidental death insurance, including rates of cooling-off cancellations, short-term lapses, and claims outcomes. If we remain concerned about consumer outcomes and sales practices, we will use our current and/or proposed future powers, including product intervention powers, to intervene.

### ASIC action 5: Follow-up work on LIF reforms and incentives

- The requirements imposed by the LIF reforms from 1 January 2018 reduce conflicted remuneration in life insurance sales. We will continue to assess how firms have responded to the LIF reforms; in particular, we will assess whether firms have implemented clawback provisions alongside the commission cap where appropriate.
- The introduction of the LIF reforms should lead to lower lapse rates, and we will monitor these outcomes on an ongoing basis: see ASIC action 1.
- As part of our 2021 review to test whether the LIF reforms have achieved their objective of improving the quality of advice, we will also assess whether a reduction in conflicted remuneration has led to better consumer outcomes in the direct life insurance channel.

# ASIC action 6: Information on ASIC's MoneySmart website to help consumers

We have updated our MoneySmart website to help consumers make informed decisions about buying life insurance.

### A The direct life insurance market

### **Key points**

Direct life insurance gives consumers the option of buying life insurance without personal advice and outside their superannuation fund.

The direct life insurance market is diverse and changing—a range of different products are available, which are distributed in a variety of ways, including by phone and online. The firms in our review represent a cross-section of the market in size, growth, business models and products.

Different business models and ways of distributing direct life insurance can involve participants other than insurers. Where multiple parties are involved in a value chain, we expect all of these parties to take ownership over consumer outcomes.

Our consumer research found that consumers who bought direct life insurance tended to be female, aged under 40 years, and parents of school aged or younger children. While most had tertiary education, just over one in 10 had not completed high school.

Insurers and distributors must meet statutory obligations, with oversight by APRA and ASIC. Regulatory reforms have had, and continue to have, a promising impact on industry practice and sales conduct.

- In our review, we conducted research about the direct life insurance industry as a whole and collected data from the firms in our review to understand the market in Australia and how it has changed in recent years.
- We also engaged Susan Bell Research to conduct consumer research to develop an understanding of who the buyers of direct life insurance are.

### What is direct life insurance?

- Life insurance is 'direct' when it is not sold by an adviser with personal advice or as part of a superannuation fund or group cover.
- With direct life insurance, only general financial product advice or factual information is provided at the point of sale. General advice is limited to information about the life insurance product and its features and benefits. It does not take into account a person's objectives, particular circumstances (e.g. financial situation) and needs.

Note: See <u>Regulatory Guide 175</u> *Licensing: Financial product advisers—Conduct and disclosure* (RG 175) for more indicators of what is personal and general advice.

#### **Products and distribution**

The following direct life insurance products were included in our review:

- (a) Term life insurance—This product provides a lump sum payment if the consumer dies. Exclusions, particularly for pre-existing conditions, can vary between policies.
- (b) Trauma—This product provides a lump sum payment if the consumer is diagnosed with certain medical conditions or undergoes certain medical procedures. It is sometimes offered as a standalone product, or as an optional benefit with a term life insurance policy.
- (c) Total and permanent disability (TPD) insurance—This product generally provides a lump sum payment if a consumer is found to be totally and permanently disabled and cannot continue working. It is typically offered as an optional benefit with a term life insurance policy.
- (d) *Income protection insurance*—This product provides payments if the consumer cannot work due to sickness or disability, typically an agreed monthly amount limited to a proportion of the consumer's income.
- (e) Accidental death insurance—This product provides payment if the consumer dies due to an accident; it specifically excludes death due to illness or disease.
- Consumer credit insurance and funeral insurance are also commonly sold through the direct channel. We excluded these products from our review due to other ASIC work focusing on these products. However, many of the findings in this review also apply to the sale of these products, and we expect firms selling consumer credit insurance, and in particular funeral insurance, to act on our findings and recommendations.

Note: See Report 256 Consumer credit insurance: A review of sales practices by authorised deposit taking institutions (REP 256) and Report 454 Funeral insurance: A snapshot (REP 454). For details of our follow-up review to REP 256, see Media release 17-255MR Banks to overhaul consumer credit insurance sales processes (1 August 2017).

- 90 Direct life insurance products are typically distributed:
  - (a) by inbound and/or outbound phone sales;
  - (b) online; and
  - (c) in bank branches.
- Less common distribution channels include sales of direct life insurance through credit or mortgage brokers, or through financial advisers but without personal advice.
- Consumers who buy direct life insurance most commonly used phone and online distribution channels, with 74% of respondents in our consumer research first making contact with the insurer through these channels (see REP 588, pp. 25–26). For this reason, and due to the difficulty of reviewing face-to-

face sales in branches, we focused on phone and online sales. However, many of our findings can be applied more generally to other distribution methods, and we expect life insurers selling direct to apply our recommendations more broadly.

- Direct life insurance products have a variety of underwriting processes, and some products have more exclusions and limitations. They can be broadly categorised as follows:
  - (a) Underwritten products—The firm assesses the risk it will take on before issuing a policy by asking the consumer a range of questions. The extent of these questions can vary and may cover height and weight, current and past medical conditions, occupation and lifestyle, and recreational activities. Outcomes after the underwriting process include being covered in full, increases in premium for higher risk (so called premium loadings), modified or limited coverage, or being denied cover altogether.
  - (b) Guaranteed acceptance products—The consumer is only required to meet basic eligibility criteria. The consumer will usually be asked for age, sex and smoking status to determine the price of their policy, but not about their health status. Rather than assessing the consumer's individual risk, the insurer applies broader exclusions and limitations on these products, including pre-existing condition exclusions for some products.
- Our review looked at both types of policies. For a discussion of the implications of these different product types, see paragraphs 321–365.

### Market participants

Many firms participate in the product design, underwriting, marketing, distribution, administration and claim processes of direct life products: see Table 2.

Table 2: Who's who in the direct life insurance market

Participant	What they do
Insurers	Insurers design, underwrite and issue the life insurance policy, and are responsible for making claim payments. They may sell their products directly to the consumer or through a distributor. They need to be authorised by APRA and generally need to hold an Australian financial services (AFS) licence issued by ASIC. Where insurers sell their products through a distributor, they will pay that entity commission and potentially a share of profits.
Friendly societies	Firms that issue life insurance and are structured as a friendly society are owned by members, not shareholders. Friendly societies conducting a life insurance business must be registered by APRA under the <i>Life Insurance Act 1995</i> (Life Insurance Act), and usually need to hold an AFS licence issued by ASIC.

Participant	What they do
Distributors	Distributors are third-party sales partners, who typically hold an AFS licence. A distributor conducts sales activities and will often also engage in product design, marketing and policy administration. Many distributors also handle the administrative tasks associated with claims handling, such as communicating with consumers; though those who have a delegated authority from insurers can play a greater role and decide on claims, often up to an agreed value. They generally do not need to be authorised by APRA.
	Distributors will receive payments from the insurer whose products they are selling. Payments can involve commission based on volume or value which may include acquisition cost funding, and there may be profit-sharing agreements in place.
Reinsurers	Reinsurers share risk on insurance policies or a portfolio of insurance policies with an insurer in return for a premium. Some reinsurers also operate directly as an insurer, issuing life insurance policies to consumers through a distributor. They generally need to be authorised by APRA but do not need to hold an AFS licence. Reinsurers may also contribute to commissions or other payments made to any distributors in the value chain.
Lead generators	These firms identify individual consumers who are potentially interested in buying life insurance. Lead generators use a variety of methods to identify and contact consumers including by phone and online. They are generally not regulated by ASIC unless they engage in other activities that require an AFS licence. However, they are subject to a range of obligations outside ASIC's jurisdiction (e.g. compliance with the 'do-not-call' and 'anti-spam' legislation).

- The sale of direct life insurance can involve different participants and business models. For example:
  - (a) some insurers sell directly to consumers;
  - (b) some insurers have one or more distributors who sell their products; and
  - (c) reinsurers can have direct relationships with distributors where they act as the insurer (i.e. they effectively issue the life insurance product, but all financial services activities are conducted by the distributor).
- Our review focused primarily on insurers, reinsurers issuing life insurance, and distributors given their direct involvement in the design and sale of direct life products. Lead generators are an important part of the distribution chain, given their role in outbound sales. However, these firms are largely outside ASIC's jurisdiction and were not the focus of this review.

All firms in the direct life insurance market have a role to play in achieving good consumer outcomes. We expect that all firms will take responsibility to do what is right by consumers.

### What does the market look like?

Direct life insurance is a diverse and changing market. Our review indicates that part of this diversity and complexity is because firms selling life insurance policies have different business and distribution models.

### Firms in our review

We included six insurers, one reinsurer (acting as a direct insurer), one friendly society and three distributors in our review.

Note: Our call review findings refer to eight firms, comprising three distributors and five insurers selling directly (one insurer selling directly exited the direct life insurance market during the early stages of our review). Our sales, claims and lapse data was collected at an insurer level, and these findings refer to the eight insurers (including the reinsurer and friendly society) in our review. See Appendix 1 for the names of the firms included in our review.

- The firms in our review represent a cross-section of industry including:
  - (a) product types, distribution and underwriting models (see paragraphs 88–93);
  - (b) business models (see paragraph 96); and
  - (c) market share (e.g. larger and smaller participants, in terms of new sales and policies in force as at 2016).
- These firms made up approximately 80% of new direct life insurance sales by annual premium from 1 January 2016 to 30 June 2017 for the products in our review.

Note: This estimate is based on annual premiums of new business collected by APRA as part of the <u>APRA-ASIC claims data collection</u>. This data was produced by insurers on a 'best endeavours' basis and is not publicly available other than on an aggregate industry level basis as part of the pilot phase of this claims data collection.

- During our review there were substantial changes in the business structures and offering of direct life insurance, including:
  - (a) one insurer exited the direct life insurance market;
  - (b) two distributors have temporarily stopped selling direct life insurance; and
  - (c) four insurers were sold or are in the process of being sold to new owners by the Australian banks that owned them.

In addition, some insurers and distributors changed the distribution agreements they operated through and entered into new partnerships during the period for which we collected data. Many firms also made substantial changes to the scale and nature of their product offering, with some expanding and others consolidating.

#### Recent trends

We collected sales data from the firms in our review relating to new policies sold during the period 1 January 2014 to 31 December 2016, and in-force policies at the start and end of each year: see Appendix 1 for details.

During this period, the number of lives insured increased for most types of cover, with trauma cover increasing by over 50%: see Figure 1.

300,000 Term life 250,000 Accidental death Income protection Number of lives insured TPD 200,000 -Trauma 150,000 100,000 50,000 0 2014 2015 2016 2017

Figure 1: Lives insured at start of year, direct life insurance, 2014–17

Source: All figures in this report are based on data collected by ASIC from the eight insurers included in our direct life insurance review, unless stated otherwise.

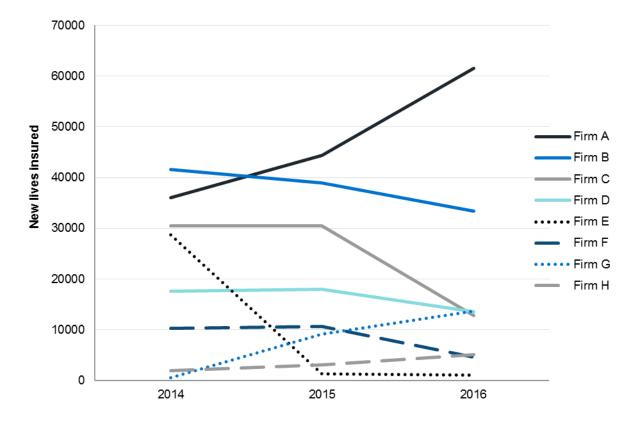
Note 1: In-force lives insured for the start of 2017 are based on figures as at 31 December 2016. One firm was unable to provide lives insured for the beginning of 2014 due to system migration limitations and has therefore been excluded from this figure.

Note 2: See Table 3 in Appendix 2 for the underlying data shown in this figure (accessible version).

As can be seen in Figure 1, accidental death was the only cover type that had a reduction of in-force policies during 2014–16. This was in part influenced by one insurer who had the most in-force lives insured and ceased selling accidental death insurance during this period.

While the market has grown overall, this has not been the case for all firms—five firms in our review substantially reduced new sales over the past few years. This is evident when looking at new sales of direct life insurance for 2014–16: see Figure 2.

Figure 2: Lives insured for new sales, 2014-16



Note 1: The letters designating firms vary throughout this report (i.e. Firms A–H do not represent the same firm in each figure). Note 2: See Table 4 in Appendix 2 for the underlying data shown in this figure (accessible version).

There was also substantial change in the way that individual firms distributed their products. While most firms reduced their new outbound sales, one firm in particular substantially increased this activity over 2014–16: see Figure 3.

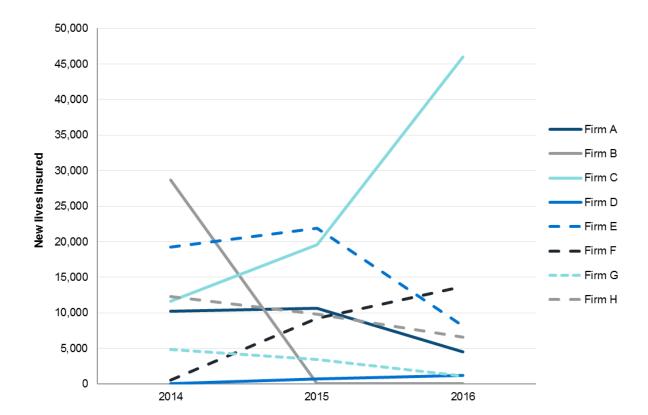


Figure 3: Lives insured for new sales—outbound sales, 2014-16

Note: See Table 5 in Appendix 2 for the underlying data shown in this figure (accessible version).

- Based on discussions with industry participants, we are aware of a general move in the market move towards offering more underwritten products. This is particularly relevant for term life and income protection products, which are often available as both underwritten and guaranteed acceptance: see paragraphs 321–329.
- For the firms in our review this was reflected in a small shift towards a larger proportion of new sales being underwritten, from 69% in 2014 to 73% in 2016: see Figure 4.

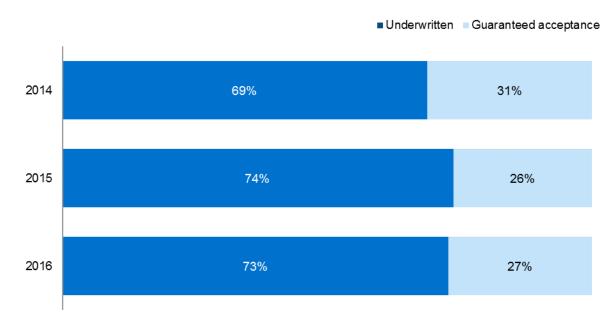


Figure 4: Proportion of new sales—Underwritten versus guaranteed acceptance, 2014-16

Note 1: This figure is based on lives insured for new sales of term life and income protection insurance where the policy was categorised as underwritten (either full or limited underwriting) or non-underwritten by the firms in our review.

Note 2: See Table 6 in Appendix 2 for the underlying data shown in this figure (accessible version).

### Who buys direct life insurance?

Our consumer research found that consumers who bought direct life insurance tended to be female, aged under 40 years, and parents of school aged or younger children. Most had a university degree, trade certificate or diploma—although just over one in ten (12%) had not completed high school, reporting their highest level of education as primary school or grade 10.

Note: For all data references in this section, see REP 588, pp. 14–17, unless otherwise stated.

Of the survey respondents, 41% worked full time, 19% worked part time, 7% were casually employed and 29% were not in the paid work force (i.e. home duties, retired, student or NewStart or the Disability Support Pension recipients).

Note: The total for 'employment' does not equal 100% as some respondents preferred not to disclose their employment status.

Only 16% of respondents reported already having insurance as part of their superannuation. We consider this in part reflects some consumer demographics (e.g. the high proportion of consumers not in the paid work force). However, it is still very likely to be under representative as almost all superannuation funds provide life insurance on an opt-out basis.

- It is notable that two in five of the respondents were prompted to buy direct life insurance by sales and marketing activities. Almost one quarter (23%) of the respondents bought insurance directly after seeing or hearing advertising or marketing, and one in five (19%) were responding to an outbound sales call. Being diagnosed with a medical condition was a trigger to buy for 16% of respondents.
- A life event, such as getting married, changing jobs, having children or the death or illness of a friend or family member, was a trigger to buy for around two in five (38%) respondents in the consumer research.
- Our consumer research identified three types of consumer profiles for those who bought direct life insurance:
  - (a) *Methodical buyers*—These consumers checked details carefully and took multiple steps to research and complete the purchase.
  - (b) *Pragmatic buyers*—These consumers were aware of the need for cover and bought it with as little effort as possible, often driven by price.
  - (c) *Emotional buyers*—These consumers may be impulsive and possibly bought a policy because of a sense of obligation to the sales person or in response to emotional appeals.

Note: See REP 588, pp. 51-52.

These profiles demonstrate the different challenges consumers face when buying direct life insurance.

### How is direct life insurance regulated?

- ASIC and APRA jointly regulate the life insurance industry. ASIC is the conduct regulator for AFS licensees, including life insurers, distributors, and friendly societies, while APRA is the prudential regulator for life insurers, friendly societies and reinsurers. ASIC and APRA administer separate parts of the Life Insurance Act.
- Key obligations, recent changes and government reports relevant to the sale of direct life insurance are outlined below.

### Conduct obligations

- ASIC regulates AFS licensees, including life insurers, distributors, and friendly societies. Under the *Corporations Act 2001* (Corporations Act) AFS licensees must comply with general obligations (s912A), including to:
  - (a) provide financial services efficiently, honestly and fairly;
  - (b) ensure that representatives are adequately trained and competent to provide financial services;
  - (c) ensure that representatives comply with financial services law; and
  - (d) have adequate arrangements in place for managing conflicts of interest.

- Other obligations under the Corporations Act include prohibitions on:
  - (a) engaging in misleading or deceptive conduct (s1041H); and
  - (b) offering financial products for sale in the course of, or because of, an unsolicited meeting or phone call (\$992A).
- The consumer protection provisions in the *Australian Securities and Investments Act 2001* operate to protect consumers from false or misleading conduct or unconscionable conduct in the provision of financial services: see s12CA, 12CB, 12DA and 12DB of that Act.
- ASIC is also responsible for the general administration of the *Insurance Contracts Act 1984*. A contractual term is implied requiring both the insurer and the policyholder to act towards the other, on any matter arising under or in relation to the contract, with the utmost good faith: see s13, 14 and 14A of that Act.
- While we considered these provisions during our review, we did not take a purely compliance-focused or legalistic approach. Rather, a key focus was to identify where sales conduct contributed to poor consumer outcomes, such as declined claims and lapses.

### Life Insurance Framework (LIF) reforms

- The LIF reforms, which came into effect on 1 January 2018, reduce conflicted remuneration in sales of life insurance, including through the direct channel.
- The reforms meant that some remuneration arrangements in direct life insurance markets need to change. We expect that these changes will drive better conduct and improved consumer outcomes, and in particular fewer lapsed policies. We discuss this in more detail at paragraphs 569–575.

#### Life Insurance Code of Practice

- The Life Insurance Code of Practice (Code) developed by the life insurance industry through the Financial Services Council (FSC) came into effect on 1 July 2017.
- The Code commits life insurers which are members of the FSC to minimum standards on sales practices and advertising, including providing certain information at the point of sale, not engaging in pressure selling, appropriate consequences for inappropriate sales conduct, and providing warnings to consumers replacing another policy.

Note: See FSC, Life Insurance Code of Practice for further information.

The Life Code Compliance Committee independently monitors compliance with the Code. The Code is not approved by or enforced by ASIC.

- Our call review indicates that the introduction of the Code has played a role in improving sales standards, including, for example:
  - (a) improved warnings about the risks from replacing cover; and
  - (b) greater focus on the challenges faced by vulnerable consumers.

Note: See Section C for further discussion of these issues.

However, our findings clearly indicate that industry must set tougher standards to improve consumer outcomes.

### **PJC** report

- A report by the Parliamentary Joint Committee on Corporations and Financial Services (PJC) released in March 2018 reviewed the following matters relevant to the direct life insurance industry:
  - (a) the need for further reform and improved oversight of the life insurance industry;
  - (b) the sales practices of life insurers;
  - (c) the roles of ASIC and APRA in reform and oversight of the industry;
  - (d) an assessment of relative benefits and risks to consumers of the direct life market.

Note: See PJC, Life insurance industry (March 2018) (PJC report).

The PJC report encouraged ASIC to include data on the connection between declined claims and underwriting practices in our review: see paragraphs 348–350.

# Design and distribution obligations and product intervention powers

As part of the Government's response to the Financial System Inquiry (FSI), in 2015 the Government accepted the FSI's recommendations to introduce design and distribution obligations for financial products to ensure that products are targeted at the right people. On 20 July 2018, the Government released a revised exposure draft for public consultation.

Note: See The Treasury, <u>Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Power) Bill 2018</u> (20 July 2018).

- The proposed obligations would require firms to identify target markets, design their products to meet these consumers' needs, and distribute them so they reach this target market. Firms would also be obliged to keep these under review.
- The intervention power would allow ASIC to regulate, or if necessary, ban potentially harmful financial and credit products where there is a risk of significant consumer detriment. The power is intended to enable ASIC to take action before harm, or further harm, is done to consumers.

### **B** Consumer outcomes

### **Key points**

Outcomes for many consumers who buy direct life insurance—as measured by claim outcomes, lapse and cancellation rates, and consumer confidence and understanding—are poor.

Across all products there were a high proportion of claims declined and withdrawn. Of all finalised claims, 79% were admitted and 21% declined. However, withdrawn claims had a substantial impact on claim outcomes, with 27% of all reported claims withdrawn, 15% declined, and 58% admitted. Outcomes were better for term life insurance, but extremely poor for accidental death insurance.

In the short term, a high proportion of policies lapsed. One in five policies were cancelled during the cooling-off period, and almost half of all policies that stayed in force beyond the cooling-off period lapsed within three years. Given that life insurance is generally designed to be held longer term, this suggests that the market is not working for many consumers.

Many consumers reported that they found the process of buying direct life insurance difficult and did not always feel very confident about their decision. After the purchase, many lacked understanding about key policy features, such as exclusions and future cost.

- Industry data in ASIC's REP 498 indicated that declined claim rates were highest for policies distributed directly. The average declined claim rates in non-advised sales were higher (12%) than retail (7%) and group (8%) channels.
- The APRA–ASIC claims data collection published new data on life insurance claims for the period 1 January 2017 to 30 June 2017. These results were consistent with REP 498: the data indicated that, on average, declined claims were higher for direct life insurance products compared to group and advised business.

Note: See Media release 18-150MR APRA and ASIC release new life-claims data (24 May 2018).

- We were also concerned that there may be high lapse rates, and in particular short-term lapse rates, in the direct life insurance market. For these reasons, we collected claims and lapse data for direct life insurance products, to identify where consumer outcomes could be improved.
- Our consumer research also gathered information about how consumers felt after they had bought a policy, including their confidence that they had bought the right policy and what they knew about common policy features.

We consider how factors such as sales conduct and product design contribute to the poor consumer outcomes we identified, in Sections C and D.

### Claims outcomes

- 143 Claims will ultimately be accepted or declined by an insurer or withdrawn by the claimant (either by actively withdrawing the claim or by failing to provide required documents to proceed).
- High levels of declined and withdrawn claims suggest that products are not performing as consumers expect them to. They can indicate potential problems at the point of sale which lead to the consumer or their family believing they are covered for more than they actually are. For example, consumers may not have received a clear and full explanation of the cover and its limitations, they may have been misled, or they may have been subjected to selling techniques that reduce their ability to make an informed decision about the cover.
- Claim outcomes for direct life insurance were poor, relative to life insurance sold through other channels. The APRA–ASIC claims data collection found that 93% of finalised claims across all channels (advised, group and direct) were admitted, while for the direct channel this was only 84%.

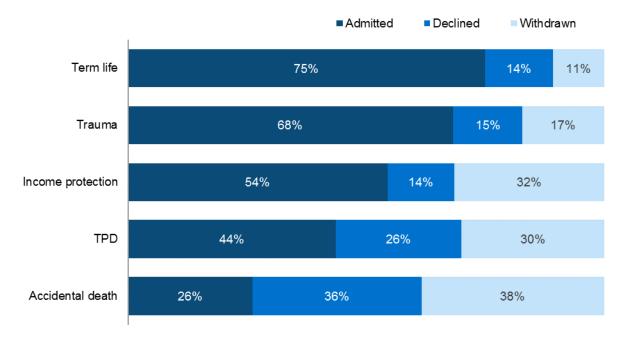
Note: See APRA, <u>Response to submissions: Life insurance—Public reporting of claims information—Update on progress</u> (24 May 2018), pp. 13, 38. Admitted claims exclude funeral insurance and consumer credit insurance as these products were not included in our review and are generally not sold through advised or group channels.

- Data collected from the firms in our review for 2014–17 showed an even lower rate of admitted claims, with 79% of finalised claims admitted and 21% declined.
- The APRA–ASIC claims data collection considered the proportion of finalised claims (i.e. those that have been admitted or declined). However, we also analysed the outcomes for all reported claims, and particularly the impact of withdrawn claims. High rates of withdrawn claims can indicate that a consumer, or their family, held a policy that they did not understand or did not meet their needs. Across all direct life insurance products, 27% of reported claims were withdrawn, 15% were declined and only 58% were admitted. This declined rate was even higher than that identified in REP 498 (12%); withdrawn claims were particularly high (27% in this review compared to 11% in REP 498).
- For some firms, withdrawn rates are high due to the practice of recording a claim inquiry as a 'reported claim', and recording this as 'withdrawn' if the consumer does not take any further action after the initial inquiry. We note that REP 498 made a key observation on the need for better quality and more

consistent data across industry; the APRA-ASIC claims data collection aims to ensure more consistent, comprehensive and reliable data.

We found that outcomes for reported claims differed substantially across different products, with term life insurance having the highest acceptance rate (75%) and accidental death insurance the lowest (26%): see Figure 5.

Figure 5: Claims admitted, declined and withdrawn, by product type, 2014-17



Note 1: This data includes claims admitted, declined or withdrawn, between 1 January 2014 and 30 June 2017, as a proportion of claims reported but excluding claims not yet determined as at 30 June 2017. The methodology we used for determining claim outcomes is different to that used in the APRA-ASIC claims data collection, which analysed the proportion of claims finalised (i.e. admitted or declined). While this different methodology results in lower rates of admitted and declined claims, the data we collected for the equivalent period is closely aligned with the findings of the APRA-ASIC claims data collection.

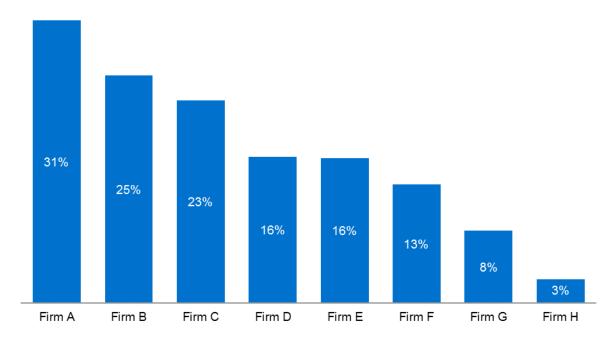
Note 2: See Table 7 in Appendix 2 for the underlying data shown in this figure (accessible version).

- Anecdotally, some firms have indicated that poor claim outcomes in direct life insurance are in part a result of 'adverse selection'. This is where consumers are prompted to buy life insurance after receiving a diagnosis or because they suspect they may be ill, and then do not disclose this or hope it will not be caught by a pre-existing medical condition exclusion. Some firms also told us that adverse selection would particularly skew claims outcomes if policies have only been in force for a short period of time.
- While adverse selection can explain some poor claims outcomes, and medical conditions appear to be a trigger for some consumers to buy life insurance (see paragraph 115), we do not agree that this factor alone can explain the discrepancies between direct and other channels. As discussed in Section C, we think firms can do a lot more to ensure that the limitations and exclusions of some direct life insurance policies are clearly explained to consumers (see paragraphs 184–192) and the implications of non-disclosure.

### **Policy lapses**

- A lapsed life insurance policy occurs when the insurer or consumer cancels the policy, usually where:
  - (a) the consumer proactively contacts the insurer to cancel the policy; or
  - (b) the insurer cancels the policy due to non-payment of premiums.
- Lapses that occur within a relatively short period may indicate that the consumer did not want to buy the product, realised it did not meet their needs, or could not afford it. Medium-term lapses can indicate that a product became unaffordable as premiums increased.
- Across all firms and products in our review, aggregate lapse rates within the cooling-off period and within the subsequent three years were very high, especially considering that life insurance products are generally intended to provide cover over a long period of time.
- Almost one in five policies (18%) sold from 2012–17 were cancelled during the cooling-off period. This varied dramatically by firm: two firms had cooling-off cancellations of less than 10%, while one firm had a rate of 31%: see Figure 6.

Figure 6: Proportion of policies cancelled during the cooling-off period, by firm, 2012-17

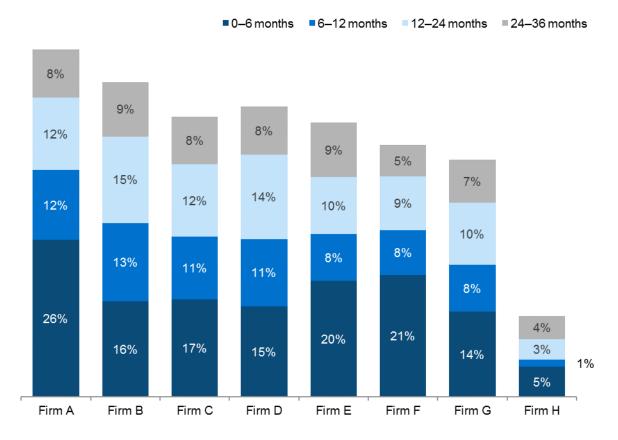


Note 1: Cooling-off cancellations include policies that were cancelled by the consumer within the cooling-off period as stated in the PDS or cancelled by the insurer due to non-payment of the first premium. In all cases, the consumer had either received a full refund of their first premium or did not pay any premiums.

Note 2: See Table 8 in Appendix 2 for the underlying data shown in this figure (accessible version).

Lapse rates after the cooling-off period were also very high. Over a quarter (27%) of all policies that remained in force beyond the cooling-off period had lapsed within 12 months and almost half (47%) had lapsed within three years. One firm had much lower lapse rates overall, with only 14% of its policies lapsing within three years: see Figure 7.

Figure 7: Proportion of policies lapsed within three years, by firm, 2012-17



Note 1: For all lapse data in our report, due to the dates at which we collected data during our review, this includes policies sold during the calendar years 2012–16 inclusive, which had lapsed as at April 2017, and policies sold in the first half of 2017, which had lapsed within six months as at 31 December 2017.

Note 2: See Table 9 in Appendix 2 for the underlying data shown in this figure (accessible version).

- Some firms told us that the high lapses in direct life insurance were due to consumers shopping around and switching policies. It was evident in around 20% of the calls we reviewed that the consumer was replacing a policy.
- However, this does not seem to account for the high lapses in full, and in Section C we discuss other conduct we identified that may be driving this. We are also concerned that high rates of switching are not in consumers' interests in the direct life insurance market.
- 159 Consumers have poor understanding of the future cost of their cover and key exclusions (see paragraph 171), and the poor explanations they receive at point of sale likely contribute to this. This means that consumers who are prompted to switch by a year-on-year premium increases face two risks:

- (a) First, as explanations about future cost are poor (see paragraphs 197–202), it is likely that consumers will be prompted to switch again when they face unexpected premium increases in subsequent years.
- (b) Second, if consumers have developed a medical condition in the interim, it may not be covered due to a pre-existing condition exclusion, or it may be subject to a premium loading.
- This raises further concerns for consumer outcomes, and firms need to do more to improve transparency about future cost and warn consumers about the risks of replacing cover: see paragraphs 193–208.
- Some firms told us that high lapse rates were simply a 'cost of doing business' in the direct life insurance market. This position is not acceptable; high lapse rates are not in the interests of either consumers or firms.

### **Recommendation 1: Improving consumer outcomes**

- High rates of declined or withdrawn claims indicate that a product is not performing as expected, that there is a divergence between the promise and the reality. We expect industry to improve outcomes in this regard.
- High cancellations during the cooling-off period and high lapses indicate that many consumers are buying cover that they did not want, that was not right for them, or that they could not afford. We expect firms to take clear and immediate steps to improve performance across direct life insurance products. In order to do this, all parties in the value chain (i.e. distributors, insurers and reinsurers) must make an active commitment to improve outcomes in this area.
- We expect all firms to do more to understand what causes poor consumer outcomes such as declined and withdrawn claims and lapses in their particular business. Firms should then take action to make necessary changes to sales or product design to address these issues, including but not limited to those identified in this report. This may involve taking action beyond just strengthening disclosure at point of sale to improve outcomes. A focus on lower lapse rates should not result in aggressive retention.

### ASIC action 1: Monitoring and publication of consumer outcomes

Following the release of REP 498, APRA and ASIC have worked collaboratively to establish a public reporting regime for life insurance claims information with the aim of improving the accountability and performance of life insurers. We have published aggregate industry data already and propose to publish individual insurer data in the future to provide transparency about claim outcomes for consumers, including for direct life insurance.

We will also collect data on a six-monthly basis on cooling-off cancellations and short-term lapses to test whether consumer outcomes improve. If outcomes do not improve, we will consider what further regulatory interventions will be necessary, using the full range of our powers.

### The consumer experience

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Our consumer research showed that within six months of buying their policy, many consumers said they had found buying life insurance direct a difficult experience. After the sale, they lacked confidence in their decision and showed a lack of understanding about exclusions and future cost.

Note: For all data references in this section, see REP 588, pp. 3-8.

- Before they bought the policy, most respondents knew little or nothing about life insurance, and two thirds had not undertaken any research. While half of the respondents had thought about the type of insurance, the level of cover or the premiums they wanted, few had considered all these elements.
- Only one in six respondents had considered the implications of their health on their cover, and some struggled to understand how any pre-existing conditions would affect their cover.
- Several factors other than cover influenced purchasing decisions, including trust in the brand, the ease of the process, and gifts or promotions. Price was an important factor, with consumers heavily focused on what they could currently afford. Many consumers were guided by suggestions from the sales person about the type or level of cover.
- While four in five respondents felt very or fairly confident that they bought the right policy, most were not aware of what exclusions applied. Most were also unsure about the future cost, with just over one third assuming it would stay the same, and two in five unclear how increases would be calculated.
- The terminology, variety of products, add-on benefits and promotions being offered made the sales process confusing and time consuming. Some respondents found the process overwhelming and were unclear about what they bought.
- However, not all consumers had a difficult experience. Some consumers who bought direct life insurance researched extensively and used both online and phone sales channels to buy the cover they felt was right for them.

# C Sales conduct

#### **Key points**

Our review of sales calls identified sales practices that increase the risk of poor consumer outcomes.

All the firms in our review failed to consistently provide adequate information at the point of sale about important aspects of the policy, such as exclusions and future cost.

Other practices of concern included:

- four firms engaged in some pressure selling and other conduct that prioritised a sale ahead of the needs of the consumer;
- six firms downgraded consumers to more limited cover, sometimes without providing adequate warnings; and
- most firms engaged in conduct that was likely to reduce informed decision making.

We are concerned that outbound sales are more commonly associated with poor sales conduct and substantially increase the risk of poor consumer outcomes.

## Sales conduct leads to poor consumer outcomes

- We completed two sales call reviews to understand if sales conduct contributes to poor consumer outcomes, such as policy lapses and declined claims.
- In our first call review, we listened to 151 sales calls from 2010–16 where the policy had lapsed or there had been a declined claim. We reviewed the calls and the reason why a claim was declined or a policy had been cancelled/had lapsed, to see if there was a link between what happened during the call and the poor outcome.
- Our assessment was that poor sales practices likely contributed to 35% of declined claims and 63% of lapsed policies. The conduct likely led to consumers buying a product:
  - (a) they did not want or could not afford, resulting in a lapsed policy; or
  - (b) that did not perform as they expected or did not meet their needs, resulting in a declined claim or lapsed policy.

Note: See Appendix 1 for full details of our methodology.

- We reviewed 88 policies that had lapsed within three years of the sale and identified conduct in 55 sales calls that likely contributed to the lapse:
  - (a) Failure to discuss stepped premiums—The increasing cost of the policy was not discussed with consumers in 29% of sales calls where the premium later increased and the policy lapsed at the time of or after the premium increase notice.

- (b) Pressure selling—In 13% of sales that lapsed outside the cooling-off period, the consumer indicated they wanted time to think about their purchase but were pressured to sign up immediately and use the cooling-off period to review their decision.
- (c) *Promotions*—A promotion or 'gift with purchase' was mentioned in 31% of sales calls where the policy subsequently lapsed. Promotions were mentioned more frequently in shorter-term lapses—that is, lapses within six months had promotions mentioned most often.
- (d) Reducing consumer choice—In 50% of the lapsed policies, the sales person led the conversation on the cover type and/or level of cover selected, with little or no input from the consumer. This was often done during outbound sales calls where the consumer was less likely to have thought about what cover they needed or whether they needed life insurance.
- We reviewed 63 policies that resulted in a declined claim and identified conduct in 22 sales calls that likely contributed to the consumer not understanding their cover or having cover that did not meet their needs:
  - (a) Failure to discuss broad exclusions or limitations—13% of the claims were declined due to a broad policy exclusion, limitation or waiting period that was not discussed during the sale. In some cases, the consumer asked to receive documents to review before committing to buy the policy but were pressured to sign up immediately.
  - (b) Limitations of accidental death insurance—A further 14% were declined accidental death claims where the substantial limitations that apply to this type of policy had not been explained to the consumer. Five consumers had initially called about a more comprehensive life insurance product and had been downgraded to accidental death.
  - (c) Sales to vulnerable consumers—For three declined claims, there were indications in the sales call that the consumer did not understand what they were buying.
- The findings from this call review demonstrate a clear link between conduct at point of sale and poor consumer outcomes. It is important to note that poor conduct was in fact more prevalent in the older calls. The figures above only reflect those cases where we identified a connection between what we heard in the calls and the ultimate outcome.
- We conducted a second call review to test whether conduct that contributed to poor outcomes was evident in more recent calls. We listened to 393 sales calls from July and August 2017, after the Code had come into force on 1 July 2017. This review was designed to assess improvements in conduct and identify ongoing poor practice where standards could be improved.
- Our findings and concerns about ongoing problematic practices are discussed in more detail below.

# Inadequate explanations of key policy features

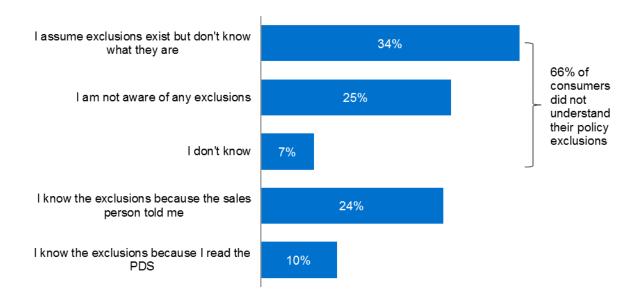
The information given during the sales process is critical to helping consumers understand the life insurance policy. Our consumer research found that 55% of respondents said they 'knew a little' or 'didn't really know anything' about life insurance before they bought a policy: see REP 588, pp. 21–22. This highlights the important role of the sales person and the quality of information required.

All firms in our review failed to consistently provide clear information about key policy exclusions and the future cost of the product. Given low levels of consumer understanding, this creates a risk that consumers will not understand the cover they have, with their policy not performing as expected or becoming unaffordable in the future.

#### **Policy exclusions**

Consumers need key information about what is covered and excluded from a life insurance policy so that they can make an informed decision. Our consumer research found that 66% of respondents did not know what exclusions applied to their policy and a further 24% relied on the sales person to provide this information. Only 10% of respondents said they understood because they read the PDS: see Figure 8.

Figure 8: Consumer research, exclusions and limits of policy



Note 1: See REP 588, pp. 46-47.

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Note 2: See Table 10 in Appendix 2 for the underlying data shown in this figure (accessible version).

Pre-existing condition exclusions are common in direct life insurance products and are applied to many guaranteed acceptance policies: see paragraphs 330–347. However, the limitations of these exclusions can be difficult for consumers to understand.

The definition of a pre-existing condition can extend to more than just conditions that have been diagnosed, for example where a consumer has experienced symptoms of a condition prior to buying their policy. A failure to explain such exclusions can have a significant financial effect on the consumer or their family if a claim is declined.

#### Case study 1: Claim declined for pre-existing condition

When a consumer applied for an income protection policy, the sales person gave a brief description of the policy including that the consumer did not have to provide any details about her medical history.

Later in the call the sales person disclosed that there was a pre-existing condition exclusion. The consumer was confused about what this meant, and the sales person explained that if she was diagnosed with something—for example, if she had a broken leg at the moment or in the previous three years—that would be classified as a pre-existing condition.

The consumer lodged a claim 20 months later when she was diagnosed with a condition that caused chronic pain in her heels and feet.

The claim was declined because, while the consumer had not received a diagnosis before taking out the policy, her medical records reflected multiple medical consultations about previous generalised aches and pains that were later linked to her diagnosis.

This example highlights that the explanation given did not make clear how broad the application of the exclusion could be and was unlikely to have prompted the consumer to consider the impact of their previous consultations.

- Six of the eight firms in our review offered products with exclusions for preexisting conditions. Four of these firms failed to provide the consumer with a clear explanation because:
  - (a) they mentioned that pre-existing conditions were excluded, but failed to provide an explanation of this;
  - (b) the description was limited to a technical explanation the consumer was unlikely to understand; and/or
  - (c) they mentioned the exclusion as part of lengthy scripted or recorded disclosures at the end of the call.
- In contrast, two firms consistently provided a clear explanation of the preexisting condition exclusion, and one firm included an example to highlight the breadth of its exclusion.

# Case study 2: Inadequate explanation about pre-existing condition exclusion in the middle of script

A consumer wanted to buy term life insurance and was offered a guaranteed acceptance policy.

During the sales call, the sales person stated that he needed to read some information quickly. The information took several minutes to read out with no pauses or checks that the consumer understood what was being read.

Halfway through that statement, the sales person said '...finally, I need to let you know that there is an exclusion for any mental disorder or disease, and also pre-existing medical conditions will not be covered under this policy....'

The sales person then continued with the rest of the disclosure and did not provide a further explanation of this exclusion.

It is unlikely that the consumer was able to engage with and understand the disclosures when they are provided in this way, particularly without the opportunity to interject and ask questions. Further, it relies on the consumer understanding the meaning of the broad term 'pre-existing medical condition'.

#### Case study 3: Body mass index (BMI) as a pre-existing condition

Two firms sold policies that specified if the consumer had a BMI of above 40 in the five years before taking out the policy, this would be considered a pre-existing condition for some illnesses (e.g. heart attack).

This exclusion is broader than some other pre-existing condition exclusions in the industry, so it was positive to see that one firm included a specific reference to this when discussing the exclusion with consumers, stating:

'You won't receive a payout if the claim is related to a sickness, injury or medical condition you have or have had symptoms of at any time in the five years before taking out the cover... The exclusion can apply to more than just the re-occurrence or continuation of a condition you have... To give you an example, someone who has a BMI of 40 or more would be considered to have a pre-existing condition for a heart attack.'

This type of information gives the consumer a practical explanation of how this exclusion could limit their cover and allows them to make a more informed decision about whether this product will meet their needs.

Lifestyle and occupation exclusions were also not clearly explained to consumers during sales calls. These exclusions can apply to recreational activities, work environments, drug or alcohol use, and self-inflicted injuries.

In the calls we reviewed, consumers were often not given categories or examples of exclusions but were told about 'exclusions' as a generic concept. Some firms offered to read the PDS out over the phone, which was rarely taken up by consumers. Given that PDS documents are often over 40 pages long, this is clearly not an effective way to help potential buyers understand the product.

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- More can be done to highlight key categories and examples of exclusions during sales calls, to improve consumer understanding. This is particularly important if a firm's product has exclusions which are unusual or particularly broad.
- Failure to provide explanations of key product exclusions during the sale call may lead to the product not meeting the consumer's or their family's expectations at claim time.

#### Case study 4: Claim declined for broad exclusion

An outbound sales call was made to a consumer offering term life insurance. The sales person described the cover being offered as a policy that 'covers you for death by any means'. No exclusions were discussed during the sales call.

The sales person offered to read the PDS over the phone, noting that it would take half an hour, and the consumer declined.

The consumer died as a result of suicide, and the claim was declined as this was excluded under the policy.

#### **Price increases**

- Cost is an important factor in consumers' decisions about what life insurance to buy; in our consumer research 25% of all respondents said price was the main reason they chose their policy: see REP 588, pp. 24–25.
- Life insurance premiums will generally go up each year, due to stepped premiums (i.e. changes to premiums each year based on risk factors such as the consumer's age) or indexation (i.e. cost of living increases to the sum insured designed to reduce the risk of under-insurance, with corresponding premium increases) or both: see Section D.
- We are concerned that in our consumer research 37% of respondents thought that their premium would stay the same each year. A further 39% of consumers thought their premium was likely to increase but were not sure how this would be calculated: see REP 588, p. 48.
- A failure to explain to consumers that premiums will increase could lead to policies becoming unaffordable and lapsing, or consumers switching life insurance policies without understanding the risks of doing so.

#### Stepped premiums and indexation

In our call review six of the eight firms did not discuss the increasing cost of stepped premiums unless prompted by the consumer. This accounted for 58% of the sales we reviewed with stepped premiums.

- The terms 'stepped' or 'level' were sometimes mentioned during the sales call but without any explanation. Because these are technical terms specific to life insurance, most consumers are unlikely to understand them.
- Two firms that offered both types of premium explained stepped and level premiums very clearly. In some instances, quotes were provided for both premium types with a simple explanation of how each premium type worked.
- Six firms did not explain indexation during sales calls, and in many cases, it was not mentioned at all. As with stepped premiums, this feature was sometimes referred to using industry specific terms such as 'indexation' or 'inflation protection', which we consider would not be understood by most consumers.
- While consumers can opt out of indexation, this process is often unclear or difficult: see paragraphs 383–385.
- The combination of stepped premiums and indexation can result in substantial increases to the cost over a relatively short period of time and may result in the consumer being unable to afford the policy in the long term.

#### Case study 5: Increases in annual premium

A consumer bought term life insurance. During the sales call, there was no discussion of likely increases to the cost of the policy over time.

The policy had a stepped premium and 5% indexation increase. Over just two years, the annual premium had increased by 30%, from \$30.69 to \$40.03 a fortnight.

The policy lapsed a few months before the three-year renewal date due to a failed direct debit payment.

#### Risks in replacing policies

- Because cost is important, consumers may end up shopping around to change their policy if the premium increases unexpectedly. In around 20% of the sales calls we reviewed it was evident that the consumer was replacing another policy.
- Changing life insurance policies has more risks than other types of insurance. For example, if the consumer's health or lifestyle has changed since taking out the original policy, the cost of the cover might substantially increase, or they might not be covered for events that their original policy covered them for.
- The Code requires sales staff to tell consumers who are replacing cover that they should not cancel their current policy until the new policy is in force, and explain the general risks of replacing cover, including the loss of any accrued benefits and the possibility of waiting periods starting again.

In the calls we reviewed, firms communicated this message using scripts, recordings or both, to highlight the risks associated with replacing an existing policy. However, some firms encouraged the idea of being able to compare life insurance purely on price by asking the consumer what they currently paid and guaranteeing that they could provide something cheaper, without noting that various product features might differ.

In one instance, when a consumer indicated they were unsure about the cost of their policy the sales person directed the consumer to log on to their bank account online to confirm the premium they were paying with another provider so that a comparison quote could be generated. This concerning practice creates the incorrect impression that products can be compared on cost alone.

Firms also need to clearly discuss the premium structure of the policy to ensure that consumers understand the future cost of the policy they are switching to, and that this might differ to the policy they currently have.

#### Case study 6: Replacing a policy

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A consumer called to compare a term life policy with one he already held. The sales person asked what he was currently paying and stated that their policy had certain benefits that may not be included on his current policy. An annual quote was given that was \$300 a year cheaper.

The consumer bought the policy, increasing the sum insured so that he was paying the same amount as the policy being replaced. When the consumer received his renewal one year later, the premium had increased, and he called to cancel because it was too expensive.

#### Mandatory disclosures

We observed consistent and clear disclosure in other elements of the calls, particularly for mandatory disclosures. While firms can improve these disclosures in some ways to promote consumer engagement and understanding, all firms were complying with key compliance obligations.

Duty of disclosure and general advice warnings were completed in line with requirements. One firm went beyond scripted legal requirements and did this in a way that encouraged consumer engagement. The sales staff delivered these disclosures in a conversational tone at logical points throughout the discussion.

In contrast, another firm bundled all of the disclosure information into a lengthy five-minute recorded message at the end of the call. Predictably, consumers did not engage with this delivery method and could often be heard talking in the background of the call while the recording played.

To encourage consumer engagement and understanding, firms should deliver warnings and disclosures at relevant points in the sale and provide practical examples as well as the prescribed wording where appropriate.

# Recommendation 2: Providing adequate explanations of key exclusions and future cost

- The Code should set higher standards about the provision of adequate information about exclusions and price features.
- Firms should clearly explain pricing features and product limitations as part of their sales calls. It is not enough for firms to rely on consumers reading the PDS—key categories and examples of exclusions should be highlighted during the sales call.
- 215 Pre-existing condition exclusions, in particular, should be clearly explained to the consumer, with practical examples to highlight the breadth of this exclusion. To further improve consumer understanding and decision making, sales staff should discuss exclusions at the same time as they explain the benefits of the product—firms should not rely on including key exclusions in a lengthy pre-recorded or verbatim disclosure.
- Sales staff must provide a clear explanation to consumers about the future cost of the policy and the features that will result in the premium increasing, such as stepped premiums and automatic indexation increases. These explanations should be in simple English and provided at a relevant time during the call (e.g. when confirming the cost of the policy).

# Pressure selling and downgrading cover

- Pressure selling involves sales staff using a range of tools and techniques to persuade consumers to make a purchase when they would not otherwise have done so. Pressure selling can take many forms, and can be overt and explicit, or more subtle and indirect.
- We are concerned that pressure selling results in consumers taking out cover that they do not want, cannot afford or that does not meet their needs. This in turn increases the risk of policies lapsing or claims being declined, or consumers holding multiple policies that they do not need.
- Downgrading happens where a consumer is offered an alternative and generally more limited life insurance policy because they are ineligible for the cover they originally applied for. Firms will downgrade consumers to offer them some level of cover, even if limited, rather than nothing at all.

### Using deferred payment arrangements

- 220 Conduct we observed that pressured consumers to buy included firms:
  - (a) refusing to send out further information to consumers who wanted more time to consider the insurance unless they committed to buy; and
  - (b) using deferred payment arrangements—that is, setting up the first payment date at some point in the future—to persuade consumers to buy insurance when they were not yet ready to do so.
- Firms often combined these two techniques: consumers were told that they had to commit to buy to receive documentation but were reassured that the deferred payment period would give them time to consider the cover.
- In the older calls that we reviewed, a common practice was for firms to push a sale on the basis that the consumer could cancel during the cooling-off period. In the more recent calls, firms had moved to using the deferred payment option as a technique to close the sale instead of the cooling-off period. Both techniques are inappropriate and are likely to make consumers feel pressured to buy and reduce informed decision making.
- In some cases, the sales person would agree to a consumer's request to send out paperwork but would only make clear later in the sales call that the consumer had to give payment details and commit to buy for this to happen.
- The impact of this technique was evident through our consumer research, where 22% of respondents felt they had to agree to buy a policy before they could see the policy details: see REP 588, p. 39.

'They won't send you the paperwork until you start the process of payment.' (Term life insurance. Online and phone. Female aged 47.)

#### Case study 7: Payment details needed to receive paperwork

A sales person made an outbound call to a consumer to provide a quote for life insurance. The consumer said she had just woken after a night shift and would like documents sent to her to consider when she was not so tired. The sales person said, '...yes, that's what we do—we send it all out to you and you can always increase or decrease [your cover] after that. You have that flexibility.'

The sales person continued, then later in the call said, 'What we do for all of our customers is we send out all the policy documents first via email and through the post and we don't require any payment, and we defer that to the date of your preference.' The consumer provided her payment details but contacted the firm six months later because money had been coming out of her account and she disputed that she had agreed to buy the policy.

#### **Objection handling**

- Objection handling involves sales staff using a range of persuasion techniques to overcome a consumer's reasons for not wanting to buy. We saw evidence of inappropriate and excessive objection handling.
- In some calls, sales staff ignored or refused to accept that a consumer was not interested and proceeded with the call regardless. In others, techniques that play on behavioural biases were used to overcome objections, including:
  - (a) creating a sense of urgency (e.g. by telling a consumer that a 15% discount on their premium was only available that day);
  - (b) creating a sense of scarcity (e.g. by stating that if the consumer shopped around but did not find another offer, the current policy may no longer be available to them); and
  - (c) playing on consumers' emotions (e.g. by asking how their family would cope with debts left behind or how their children's lives would change if the consumer passed away without life insurance).
- We also saw examples of sales staff dismissing consumers' objections that they already had life insurance, for example by seeking to underquote their existing cover or making unsubstantiated claims that their cover was equivalent or better.
- We are particularly concerned about such conduct, given similar concerns we expressed in 2011 about sales practices for consumer credit insurance and that this conduct did not meet our regulatory expectations: see REP 256.
- We also observed other behaviours in calls that made it difficult for the consumer to end the call without agreeing to buy. Specifically, we are concerned about sales staff:
  - talking at length and without pause, giving consumers no opportunity to object or ask questions (the effect being that consumers appear to be 'swept along' or 'worn down'); and
  - (b) investing significant time and effort in building rapport with consumers (while this can be positive if it facilitates an open conversation about cover, it can also mean that consumers find it hard to say no because of the relationship that has been established).
- Our consumer research confirms that pressure can take many forms. Some people felt pressure on the phone because they did not have enough 'time to think', especially when the sales person kept talking: see REP 588, p. 37.
  - 'I was ready to say 'no', but they kept talking.' (Trauma cover and funeral insurance. They phoned her. Female aged 37.)
  - 'The salesman was very chatty, lots of general comments and chit chat but I just wanted to get it over with.' (Term life and trauma insurance. She phoned them. Female aged 43.)

Others found the implied social obligation too much to take, especially if sales staff created a sense of good will on the phone: see REP 588, p. 37.

'I am easily pressured into things I would prefer not to do... The sales person was nice...it's hard to say no.' (Term life and funeral insurance. They phoned her. Female aged 37.)

- Not all firms in our review engaged in pressure selling conduct. We saw evidence of explicit pressure selling (deferred payment and objection handling) in four of the eight firms in our review. For one firm this was common and potentially systemic: the firm used the deferred payment method to pressure consumers in 30% of calls. For the other three firms, this tactic was used less often but still raised concerns that some consumers felt pressure to buy.
- The consumer research supported our finding that while a substantial number of consumers felt pressured when buying life insurance direct, such conduct is not universal. While almost a quarter of respondents (23%) indicated they felt 'a little' pressure and 8% felt 'a lot' of pressure to buy the policy, six in ten (60%) reported feeling no pressure: see REP 588, pp. 7, 36–37.

#### Case study 8: Pressuring consumers to buy

Example 1—Inappropriate and excessive objection handling: During an outbound sales call, a consumer told the sales person repeatedly that he was not interested in buying term life insurance. He had cover through his superannuation fund and was happy with that. The sales person kept talking, keeping him on the phone and insisting that people have other cover outside of super. The consumer again said he was not interested, so the sales person suggested a low level of cover which was relatively cheap. The consumer asked for the minimum amount of life insurance and ended up buying a \$50,000 term life policy with \$50,000 of accident cover as well. It appeared that this consumer did not want this cover but did not know how to decline when his objections were disregarded by the sales person on multiple occasions.

**Example 2—Creating a sense of scarcity and using the cooling-off period:** A consumer called to buy term life insurance. He was a commercial diver and having cover for his occupation was important to him. After underwriting, an exclusion was applied to the policy for death due to diving activity. The sales person talked without stopping for more than 10 minutes, stating that if the consumer did not put the policy in place immediately, he may not be able to get cover with another firm, or with this firm. He told the consumer, 'I have seen instances where you could have got cover but then come back later only to find ... it is declined.' The cooling-off period was used to persuade the consumer to sign up now and to cancel if he was not happy with the cover.

Example 3—Building rapport and playing on consumer's emotions:

At the beginning of an outbound sales call the consumer said she was not interested in life insurance. The sales person continued the conversation, asking personal questions, including how old the consumer's five children were. The sales person used the names of the consumer's five children on multiple occasions throughout the call. Later in the call the sales person said, 'What sort of situation do you think it would leave them [your kids] in if you didn't get around to organising anything and something did happen?'

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#### Case study 9: Pressure sales contributing to lapsed policies

During an outbound call, a consumer asked for paperwork to be sent out. She said she wasn't going to make a decision now and would take some time to work out what she wanted.

The sales person said that no premiums would be taken out that day and that the consumer could decide when they would be taken out. The sales person then immediately started asking underwriting questions at which point the consumer said, 'It's only a quote for now, isn't it?'

The sales person responded, 'What is?' The consumer reiterated her question, 'It's not actually a policy yet?'

The sales person avoided confirming that they were going through a sales process and instead asked the consumer if she understood the process that had been explained before.

The consumer reiterated that she did not want to make a decision that day but appeared to be worn down by the confusion of the process and eventually agreed to provide payment details to get paperwork sent out.

The policy lapsed after 11 months.

#### **Recommendation 3: Cease pressure selling**

- Pressure selling tactics create an environment where consumers are unable to take time to consider what life insurance they need and make an informed decision.
- The Code currently commits insurers to prevent pressure selling but does not articulate what pressure selling is. The Code should clearly define and prohibit pressure selling.
- We expect firms to stop using the cooling-off period and deferred payment arrangements to conclude sales. Firms that do not currently provide written quotes and policy information to consumers at the point of sale, without any commitment to buy, should introduce this process. Firms should also have clear guidelines for staff to end a sales call the first time a consumer states that they do not want to proceed.
- We welcome changes made by firms under which written quotes can be provided to consumers without them having to agree to buy a product. Under this process, the sale is concluded in a separate sales call at a later date. We expect all firms to introduce this process.

#### **Downgrading cover**

- We saw the following instances of downgrading consumers' cover:
  - (a) Three firms downgraded consumers who were ineligible for underwritten cover to a policy with a pre-existing condition exclusion.

- (b) Five firms downgraded consumers to accidental death insurance when the consumer had applied for term life insurance.
- There are limited circumstances where downgrading cover may be appropriate. However, we observed downgrading which could result in consumers buying cover that does not meet their needs and that they do not understand.
- Consistent with our concerns at paragraphs 184–192, the explanations of exclusions and limitations of the downgraded cover were extremely poor. Even where product descriptions were given in general terms, firms rarely stated explicitly that 'the product does not cover you for x', or 'this product is more limited and has more exclusions than the one you originally asked about' to warn the consumer of the risks.
- Four firms also had instances where it was not made explicitly clear that the consumer had been declined for one policy and was now being offered different cover, raising concerns the consumer thought they were buying more comprehensive cover.
- One firm had multiple examples of sales staff congratulating consumers for 'qualifying' for the downgraded guaranteed acceptance product. We are concerned that this is inappropriate and further increases the risk of consumers buying a product that does not perform as they expect it to.
- 243 Most sales in our review that involved downgraded cover were concluded in a single sales call, giving the consumer no time to consider the product and compare it to their needs.
- Downgrading cover can also be problematic due to the consumer feeling that they have invested time in the process of finding a life insurance policy, particularly where they have completed a lengthy underwriting process, and do not want to walk away with nothing. Of particular concern were situations where sales staff gave the impression that the consumer would not be eligible for term life insurance at all, when this might not be true.
- In a small number of cases, consumers who were replacing an existing policy were downgraded to a more limited policy. 12% of consumers who were replacing a policy initially called about underwritten life insurance and were downgraded to a guaranteed acceptance term life policy, which had a pre-existing condition exclusion.
- This is particularly concerning as any health issues these consumers had developed since taking out their previous policy would likely not be covered under a new policy with a pre-existing condition exclusion.

#### Case study 10: Risks of downgrading cover

#### Example 1—Downgrading cover without explaining limitations:

An outbound call was made to a consumer offering term life insurance. Underwriting was declined because the consumer was suffering from a brain tumour. The sales person said:

'Based on your last answer to the questions, the application has been unsuccessful. However, I do have a policy here that is the same as a life cover and is guaranteed acceptance, it's our backup plan. The best thing about this policy is that it covers you for a few extra benefits and will cover you if you pass away due to an accident...we don't like to tell our customers we can't help them.'

The consumer was sold an accidental death policy, which lapsed 13 months later.

#### Example 2—Suggesting the consumer could not get cover elsewhere:

A consumer called about term life insurance and the sales person provided a quote. The consumer disclosed that he had suffered a heart attack but had fully recovered. The sales person said, 'To be completely honest, that will decline on a normal life insurance policy'.

The consumer was sold accidental death and serious injury cover, which did not provide cover for any health issues at all. The consumer may have been eligible for a term life policy with a pre-existing condition exclusion with another insurer—while heart conditions may not have been covered due to his heart attack, other health conditions would have been covered.

#### Example 3—Congratulating the consumer when downgrading cover:

A consumer asked for a quote for term life insurance. After answering health and lifestyle questions, they did not qualify for underwritten cover. Instead of telling the consumer this, the sales person said:

'Congratulations! We have completed all of the health and lifestyle questions and we are able to offer you a cover today. It will be with our [guaranteed acceptance] policy, so what that means is that your premium has increased ... what that also means is that we won't cover you for any pre-existing conditions, but you will still be covered for the death benefit and the terminal illness benefit...how does that sound?'

#### Example 4—Downgrading when the consumer is replacing a policy:

A consumer was contacted after clicking on a social media article. Early in the call, the sales person asked if they had current life insurance and consumer said they did. The sales person asked about their current cover and premium, and said, 'What we want to do today is just compare apples with apples and see if we can save you some money.'

The consumer did not qualify for the underwritten life insurance. The sales person said, '...based on the answers to questions we are unable to offer you life cover at this time... So you are eligible for our accident cover...'

The sales person talked for two minutes without a break and provided a quote for the accident cover. The consumer bought the policy; however, the sales person had not explained that death by natural causes was not covered, and that this might not be the same type of cover as the policy the consumer had in place already.

#### Recommendation 4: Managing the risks of downgrading

- The Code should introduce standards for downgrading, including a deferred sales model, so that firms offer to call the consumer back at a later date, rather than complete the sale in the same call.
- If a consumer is not eligible for a product and the firm offers a downgraded option, it should give the consumer information about this product and tell them clearly upfront about the product's extra restrictions or limitations.
- Firms should also provide the PDS and arrange to call the consumer back after a set number of days has elapsed, rather than concluding the sale in the same call, so the consumer has time to consider the more limited product and whether it meets their needs. One firm in our review was proposing to move to this practice and we expect others to do the same.
- In considering consumer outcomes, firms should recognise that sometimes the best outcome for a consumer may be not to buy a life insurance product from their firm, as they may be able to get more suitable cover elsewhere.

## Reducing informed decision making

- Our consumer research confirms that buying direct life insurance is a difficult process for many consumers, and that many consumers are not well equipped to make informed decisions at the point of sale: see REP 588, pp. 3–4.
- In our call reviews, we observed examples of conduct that may have reduced the quality of consumers' decision making, sometimes because of how it encouraged known behavioural biases.
- Examples of this conduct included where sales staff:
  - (a) framed consumers' choices by suggesting the type and/or level of cover with little or no input from the consumer;
  - (b) automatically bundled in other cover types;
  - (c) engaged in cross-selling; and
  - (d) offered a promotional gift.
- Where firms engage in conduct that reduces informed decision making, the risk of poor consumer outcomes is heightened for vulnerable consumers, especially when combined with pressure selling.

## Framing consumer choices

- We identified several ways in which firms potentially framed consumers' decision making:
  - (a) Four firms had sales staff who suggested the type of cover, with one firm doing this in 60% of sales calls.
  - (b) Five firms had sales staff who suggested a sum insured for the consumer, with one firm doing this in a quarter of sales and another in a third of sales.
  - (c) Two firms automatically bundled additional cover types into the initial quote without asking the consumer if they wanted it. One firm added accident cover to 66% of term life policies sold.
- This conduct creates the risk that consumers disengage from the purchasing decision and buy cover that does not meet their needs. Our consumer research indicated that many consumers were heavily guided by sales staff when making decisions about their policy. 30% of respondents who stated they knew 'a little', 'quite a bit' or 'a lot' about their policy before they bought it, still based their decision (at least in part) on what the sales person suggested: see REP 588, p. 41.
- There are additional risks from this conduct:
  - (a) Even where consumers consider that the product or sum insured may not be right for them, they may be reluctant to override a suggestion given by a person they consider to be knowledgeable in their field.
  - (b) Consumers could be over-insured and paying for a level of cover they do not need or cannot afford if sales staff suggest the maximum sum insured for an initial quote, as was the case in some calls we listened to.
- Our call review indicates that there is likely to be a link between the use of framing techniques and poor outcomes—where cover was suggested by sales staff and does not meet the consumer's needs, it may result in the policy lapsing. In our first call review, in 65% of the lapsed policies the sales staff had suggested the type of cover and in 62% they had suggested sum insured.
- We also found that firms used other choice framing techniques in ways that could impede decisions and engagement. Examples included:
  - (a) making assumptions about consumer consent (e.g. by opening an outbound call with 'I will just go ahead and give you a quote' without establishing whether the consumer was interested, or introducing the idea of a purchase by saying 'I will get this set up for you, can you confirm you are happy?');
  - (b) only giving the consumer choices that involved a purchase (e.g. by saying 'Would you like to go ahead with the \$100k or \$200k sum insured?');

- asking questions so that the consumer would be taken through a long sequence of questions to which they would likely answer 'yes', before moving on to get consent to purchase; and
- (d) avoiding the topic of cancellation (e.g. by saying that the consumer could call later to increase or decrease their sum insured when the consumer had asked about cancellation).

#### Case study 11: Reducing informed decision making

A 20-year-old consumer received an outbound call from a sales person after a direct mail campaign. The consumer advised he already had cover. The sales person continued with the call, telling the consumer:

"...I understand you have sufficient cover in place but that's why we provide you with a one month cooling-off period so you can sit down and compare the existing policy... if you feel this cover isn't right for you all you need to do is give our customer service line a ring—it takes about two minutes to do."

The sales person continued the conversation without pause, not giving the consumer time to interject. The sales person selected three cover types and the sum insured for each, with no input from the consumer. The premium was \$49 a month.

The consumer called to cancel his cover three years later because it was too expensive and he did not need it. He said he would buy cover later in life.

#### **Cross-selling**

- Some consumers reported being overwhelmed by the number of options to consider and the complexity of the decisions they had to make: see REP 588, pp. 4, 31, 50. Cross-selling or offering 'add-on products' during the sales process can contribute to and exacerbate information overload.
- Add-on products can include cover such as trauma or TPD being offered in addition to a term life insurance policy, or other cover such as children's insurance being included: see paragraphs 397–404.
- Consumers also have to weigh up fairly complex ideas. For example, add-on products such as trauma and TPD will sometimes reduce the payout on the main term life insurance benefit if a consumer makes a successful claim.
- As outlined in ASIC's Report 470 Buying add-on insurance in car yards: Why it can be hard to say no (REP 470), cross-selling creates the risk that consumers succumb to decision fatigue and information overload.

Note: See REP 470, paragraphs 20–28.

- This can result in consumers:
  - (a) feeling overwhelmed and taking decision-making short-cuts, just buying cover that seems 'good enough';
  - (b) buying more cover than they need or can afford; or
  - (c) paying less attention to their 'add-on purchases' resulting in reduced awareness and understanding.
- Our consumer research for direct life insurance supported this finding, with some consumers indicating they felt overwhelmed when the sales person 'kept adding more things': see REP 588, p. 31.

'It feels like they are trying to sell you more than you wanted, like offering you salad with pizza.' (Income protection. Through a branch. Female aged 38)

- Another respondent who contacted a firm for life insurance ended up taking out trauma cover at their suggestion 'because it wasn't much extra': see REP 588, p. 31.
- In our call review we did not identify specific concerns in relation to cross-selling, however firms should still consider the consumer experience and avoid cross-selling or offering low value product features unnecessarily: see paragraphs 388–404.

#### **Promotional gifts**

Our consumer research identified that promotions or gifts were an important factor in consumers' decision-making process.

Note: For all references to the consumer research in this section, see REP 588, pp. 33-34.

- While there were very few instances in our call review of promotions being used to pressure sell, four firms mentioned them during sales calls, which may influence consumer decision making. One firm used a 15% discount to persuade consumers to sign up today, saying that the discount would not be available later.
- We are concerned that promotions can undermine consumers' decision making—for example, by:
  - (a) contributing to information overload;
  - (b) diverting their attention away from the core product and onto the more trivial gift; and
  - (c) prompting them to buy cover that they do not need, that is not right for them, or that duplicates existing cover.
- Our consumer research illustrates these challenges. Despite already having trauma cover with one provider, one woman took out a new trauma policy because of a \$75 gift card and the promise of a 10% refund after 12 months, valued at about \$50. Her premium was \$44 a fortnight.

Another felt that she would have compared products if she had not been so enticed by the promise of reward points:

'Pairing it with the incentive tricked my mind.' (Income protection. Online and she phoned them. Female aged 33.)

- Of the lapsed policies in our first call review, around 31% involved mention of a promotion or offer. Policies that lapsed more quickly (i.e. within the first six months) were more likely to have involved mention of a promotion.
- Our consumer research also suggests that promotions and offers can have the effect of consumers retaining cover to take advantage of the promotion, for instance, some consumers kept the policy beyond the cooling-off period because their 'gift' had not yet arrived. One research participant stated how surprised she was that the promised incentive did not arrive for several months.

'In 60 days, I haven't received any email (about the cash back). I may give them a call.' (Term life. Online. Female aged 30–39.)

This indicates that consumers are not clear about the terms and conditions of the gift when they take out the cover.

#### **Recommendation 5: Improving informed decision making**

- Firms should take proactive steps to engage with consumers in a way that will encourage, rather than limit, informed decision making.
- Firms should stop using techniques that frame consumers' choices. We expect firms to be transparent about cover options available to consumers and not to select products or levels of cover on the consumer's behalf. Firms should never bundle additional cover into a sales quote without seeking explicit consent from the consumer upfront.
- Firms should be cautious when engaging with consumers to ensure that the sales environment enables informed decision making and does not encourage consumers to base decisions on irrelevant factors, such as promotional gifts.

#### Sales to vulnerable consumers

- We identified 58 sales where there was an indicator that the consumer may be vulnerable (e.g. because of their language skills, comprehension, age, mental health, or financial wellbeing). Although most of these consumers were dealt with well, in 16 cases the consumer appeared to have difficulty understanding and this was not addressed adequately. There is a risk that these consumers bought cover that they did not understand.
- In particular, we were concerned about a small number of calls where the consumer was unlikely to be in a position to make an informed decision, or where there were clear affordability concerns. The sales person nevertheless proceeded to close the sale, sometimes using inappropriate objection handling techniques.

#### Case study 12: Poor handling of vulnerable consumers

**Example 1—Affordability:** The consumer was a Centrelink recipient with five children, who cited affordability concerns and noted her bank account was overdrawn. The sales person used the deferred payment arrangement to overcome the consumer's objections. It was very unlikely that the consumer's financial situation would have improved substantially over that time.

**Example 2—Language barriers**: The consumer indicated that they were a refugee on a bridging visa—it was evident his command of English was very poor. While it was clear he wanted some cover, it was also evident that both he and his friend who translated for him lacked the English language skills to understand what he was agreeing to buy. Despite several attempts to cancel the policy later (again hampered by language difficulties and difficulties following the prescribed process of cancelling in writing), the consumer appeared to pay premiums for a further six months before he was eventually able to cancel the policy.

While there is room for improvement, there were also examples of sales staff responding appropriately to indicators that a consumer might be vulnerable.

#### Case study 13: Appropriate handling of vulnerable consumers

**Example 1—Language barriers:** It was evident that the consumer did not speak English fluently. The sales person asked the consumer at the beginning of the call if she could understand English and if she wanted a translator. The consumer stated she did not need one. The sales person took great care to ensure that the consumer understood the content of the call at all stages—she spoke clearly and asked follow-up questions to ensure the consumer understood.

**Example 2—Possible power of attorney**: Late in a sales call, a consumer made some comments referring to a trustee. The sales person asked the consumer some questions to ensure that they were able to act in their own interests. The sales person also confirmed with their supervisor. Through their enquiries it was determined the consumer could act for themselves and was referring to a trustee of an estate rather than a power of attorney arrangement.

#### Recommendation 6: Industry-wide action to raise standards

- Industry should respond promptly to address the issues with sales conduct identified in this report that contribute to poor consumer outcomes. The FSC should introduce tougher standards in the next iteration of the Code, but firms should not wait for the Code to be updated before acting on our findings and recommendations.
- Insurers who sell their products through distributors who hold their own AFS licence should ensure their agreements with these sales partners commit the distributor to meet relevant standards under the Code.

#### **ASIC** action 2: Remediation and enforcement action

- Remediation is underway—Clearview has already started refunding approximately \$1.5 million to 16,000 consumers: see Media release 18-029MR ClearView refunds \$1.5 million for poor life insurance sales practices (6 February 2018).
- Where we saw the most concerning conduct, we are reviewing what further remediation is required by other firms to address consumer harm.
- Any firms who have engaged in the inappropriate sales conduct identified in this report must review past sales of direct life insurance and remediate consumers appropriately. This includes any firms selling direct life insurance who were not subject to this review.
- We are assessing the conduct of individual firms to determine whether enforcement action is required.

#### **Outbound sales**

- Some of the most concerning sales practices we observed, including pressure selling, were either limited to or more common in firms that still engaged in some form of outbound sales.
- In outbound sales, contact is initiated with the consumer through a call from the insurer or distributor where the consumer has not explicitly requested a call to discuss buying life insurance (examples of explicit requests include clicking on a 'call me now' button or submitting a quote request on a firm's website).
- Our review indicated that outbound sales are more commonly associated with poor sales conduct and increase the risk of poor consumer outcomes.
- In our first sales review of calls from 2010–16, all the firms in our review engaged in pressure selling conduct, including by using the cooling-off period to close sales. During this period, all the firms also engaged in outbound sales; for some, it was their main distribution approach.
- By the time of our second sales review, of calls from July and August 2017, four of the firms had moved either completely or predominantly away from outbound sales. Again, we observed a clear link between business models and conduct at point of sale. In this review, except in isolated instances, conduct that applied pressure to the consumer to buy a policy was limited to those firms still engaged in outbound sales.
- Our concern that outbound distribution models carry a higher risk of poor consumer outcomes is supported by our consumer research. For example:
  - (a) 40% of respondents felt pressure to buy a product during outbound sales calls compared to 27% for inbound calls (see REP 588, p. 37).

- (b) During inbound sales calls, 30% of respondents said they based their decision on the type or amount of cover the sales person suggested. Outbound calls showed a higher instance, with 47% saying they were guided by what the sales person suggested (see REP 588, pp. 41, 45).
- (c) Consumers who bought sales insurance in response to outbound calls were more likely to have been told that they did not need to get a medical examination and that they did not need to answer any questions about their medical history; they were also less likely to be aware of any exclusions for their policy (see REP 588, pp. 4, 32–33).
- (d) These consumers were less likely to have a specific life event in mind; they had not had the opportunity to conduct any research or thought about their need to cover specific costs, and the only information they had was that supplied by the sales person (see REP 588, p. 90).
- (e) They were also more likely to be influenced by promotions and offers (see REP 588, p. 4).
- Our call review also highlighted that some outbound sales staff made the sale when the consumer had told them they already had a similar product—they promoted their own product as superior, making the person feel as if they had bought the wrong policy: see REP 588, p. 38.
- These findings reinforce our concerns that outbound sales of life insurance are more likely to deliver poor outcomes.
- Outbound sales can take different forms, including calling consumers whose details have been acquired through:
  - (a) online lead generation, including where consumers take part in lifestyle surveys or competitions, click on sponsored content, sign up to newsletters or provide their details to access information;
  - (b) telemarketing; or
  - (c) an existing relationship with the brand or provider.
- Some firms told us that they did not consider that they engaged in outbound sales, because consumers gave consent to be called (e.g. when entering a competition), or because an external third party 'pre-qualified' leads by calling to check if the consumer was happy to receive a call.
- Even with these factors, we consider this conduct involves outbound sales, and there is a much greater risk that consumers are less engaged and informed. Consumers may not give explicit and informed consent to receive calls from either an insurance firm or a third party, as the relevant details can be buried in terms and conditions or described in very general terms.

#### **ASIC** action 3: Outbound sales

We intend to restrict outbound sales calls for life and funeral insurance. We are considering what regulatory tools we will use to implement this reform. In the meantime, the small number of firms who are still engaged in outbound sales will need to move away from this practice.

## **Branch and online sales**

While our review of sales conduct focused mainly on phone sales given the prominence of this channel, firms should also consider how to improve consumer outcomes in other channels, where consumers can face different challenges.

#### **Branch sales**

Our consumer research identified that some consumers have difficulty saying 'no' when they are interacting face to face in a branch; 34% of consumers who bought insurance in a branch felt pressure to buy.

Note: For all references to the consumer research in this section, see REP 588, p. 38.

- One consumer described how she went into the branch knowing what she wanted and having made the 'commitment' to get some cover for her mortgage, she felt that she had to agree to the insurance the bank was offering, which included not just the income protection cover that she wanted but also trauma and TPD cover.
- While we did not conduct a review of this channel, firms should apply our recommendations to branch sales, and should consider the pressure consumers can feel when they are interacting face to face.

#### Online sales

- Our consumer research reflected that most consumers will not follow just one 'path to purchase' so consumers who use online channels may also end up speaking to sales staff.
- Most of the firms in our review sold insurance policies directly to consumers online:
  - (a) five firms provided a complete online sales process; and
  - (b) one firm offered a quote process where the sale could be finalised through a call.
- Only two firms did not offer an online quote or sales process—these firms allowed consumers to provide their contact details to receive a call for a quote.

- We engaged the research firm Strategic Insight to conduct a review of online sales processes for the firms in our review. We also reviewed screenshots of online sales processes. We assessed what information was presented to consumers and how, along with key design features.
- We did not focus on price comparison websites given their limited role in the sale of direct life insurance.

Note: See Rice Warner, Life insurance aggregator review 2017.

However, price comparison websites offering direct life insurance have similar limitations and potential conflicts as other comparison sites. For example, comparison websites that offer direct life insurance may be part of the same group of companies as the insurer or distributor making the sale and may only offer a comparison of a limited range of products.

Note: For guidance on comparison websites, including disclosing links to the providers of products being compared, see <u>Regulatory Guide 234</u> Advertising financial products and services at RG 234.207–RG 234.211.

#### Relevant and accessible information

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- Consumers should be given key information at relevant points during the sales process when buying life insurance online. Displaying key information in a way that is easily digestible at a relevant point in the sales process will encourage consumer understanding and informed decision making.
- While all firms provided links to the PDS as part of the sales process, we are concerned that it unlikely that this will result in informed decision making as:
  - (a) three firms 'hid' the PDS link in the footer of the web page; and
  - (b) while most firms prompted consumers to view the PDS, it is unlikely consumers will read and easily understand a lengthy disclosure document during the online sales process.
- Some firms improved the likelihood of consumer understanding by simplifying and summarising key benefits and exclusions. For some online processes, consumers could also access key definitions and explanations without leaving the webpage, for example by 'hovering' over relevant terms during the underwriting process.
- By having immediate and relevant access to key information during the sales process, consumers are more likely to be able to buy life insurance that they understand and that will meet their needs.

### **Design flaws**

- We observed design features in some online sales processes which raised serious concerns for consumer outcomes. These included:
  - (a) one firm failed to ask employment questions that related to a consumer's eligibility to claim under the policy;

- (b) one firm required consumers to opt out of optional insurance cover and set the default amount of cover at the maximum cover available to the consumer; and
- (c) one firm automatically provided a quote for additional products that the consumer had not expressed any interest in at the end of the sales process.
- These practices were similar to some of the poor conduct that we saw in sales calls and we are concerned that they would similarly lead to poor consumer outcomes.
- For example, requiring a consumer to opt out of additional cover, or automatically quoting on this cover without the consumer expressing any interest, is similar to the bundling and cross-selling conduct that we saw in our call review. This is likely to increase the risk that consumers end up paying for cover that they do not want or need.

#### Recommendation 7: Improving face-to-face and online sales processes

- Many of the findings and recommendations from our sales call review apply to other distribution channels, including sales in bank branches or online. Firms should apply these recommendations to their other distribution channels, as appropriate.
- To encourage informed decision making, firms should incorporate easily accessible information into the online sales process (e.g. summaries of key benefits and exclusions, and definitions of key terms), rather than relying on the PDS. Additionally, we expect firms to remove elements of the online sales processes that may result in consumers buying a product that does not meet their needs (e.g. requiring consumers to opt out of additional cover).

# D Product design

#### **Key points**

To improve consumer outcomes, direct life insurance products should be designed to meet consumer needs and should perform in a way that consumers would reasonably expect.

Guaranteed acceptance products increase the risk of poor consumer outcomes—while they offer an easier and quicker application process, the nature of, and variations in, limitations mean that consumers are less likely to understand these products or make a successful claim.

The structure of life insurance premiums can also vary and the lack of transparency about future cost limits a consumer's ability to make an informed decision. We are particularly concerned where firms make it unnecessarily difficult for a consumer to opt out of optional increases, or where cover increases beyond what the consumer could ever claim.

Other design features, often promoted by firms as additional benefits, can have substantial limitations which reduce the value of the feature.

- We assessed the key benefits, exclusions and features of the direct life insurance products offered by the firms in our review to identify products or features that may contribute to poor consumer outcomes. That is, whether the products or their features were designed to fulfil a clear consumer need, offered reasonable value to consumers, and would perform as expected.
- We also compared features between the products offered by different firms to understand how varied direct life insurance products are, particularly where consumers are unlikely to be aware of these differences and the impact on the cover provided or cost of their policy.

# Guaranteed acceptance products

- The direct life insurance industry offers a range of products which have 'guaranteed acceptance' and do not require the consumer to provide any medical information or test results to buy cover, provided they meet basic eligibility requirements.
- Guaranteed acceptance life insurance is an alternative to underwritten life insurance: see paragraph 93.
- The firms in our review offered guaranteed acceptance products for:
  - (a) term life insurance (sometimes with optional trauma cover);
  - (b) income protection insurance; and
  - (c) accidental death insurance.

- While guaranteed acceptance products offer some cover with a quick application process, these products have exclusions that reduce the likelihood of the consumer making a successful claim in the future.
- Effectively, guaranteed acceptance products put the onus on the applicant to interpret and understand the exclusions in the policy, rather than going through an underwriting process at the point of sale.
- We are concerned about the sale of these products where:
  - (a) they offer extremely limited cover to consumers;
  - (b) they are provided instead of a more comprehensive product (see paragraphs 238–245); or
  - (c) the limitations and exclusions are not clearly explained to consumers before they buy the product.
- Some of the poor conduct identified in our call review, such as inadequate explanations of exclusions, and concerns about downgrading, were more common for, or completely limited to, guaranteed acceptance products.
- One firm in our review only provided underwritten term life insurance. This firm raised the fewest concerns relating to pressure selling or other inappropriate sales conduct, and also had the lowest lapse rates of all the firms in our review.
- Standalone trauma and TPD insurance were not commonly offered as guaranteed acceptance products, with only one firm in our review offering this type of product. While we have focused on certain products, our findings also apply to firms who offer other guaranteed acceptance products.

#### Term life and income protection insurance

- Of the firms in our review:
  - (a) five firms offered guaranteed acceptance term life insurance; and
  - (b) five firms offered guaranteed acceptance income protection insurance—sometimes referred to as 'bill protection'.
- When applying for these products, a consumer only needs to provide answers to basic eligibility and pricing criteria (e.g. residency status, age, gender and smoking status).
- Instead of asking about the consumer's medical history and underwriting the policy at the point of sale, the policy will have a pre-existing condition exclusion, which means the consumer is not covered for any illness or condition that they knew about, or had symptoms of, before taking out the policy.

When the consumer lodges a claim, the insurer will check whether the claim relates to a pre-existing condition, which typically involves a detailed assessment of the consumer's medical history by obtaining records from relevant medical practitioners. This is sometimes referred to as 'underwriting at claim time', as the insurer obtains the relevant medical information about the consumer at claim time, rather than before issuing the policy.

#### Consumer understanding

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- Exclusions for pre-existing conditions and how they affect a policy are difficult for consumers to understand. In our consumer research, some people did not understand that their medical records would be assessed when they lodged a claim. For example, one consumer was unsure why there was no medical assessment in the application; when she was told her pre-existing conditions would not be covered, she thought, 'How would they know?': see REP 588, p. 35.
  - Our consumer research also showed a generally low level of understanding by consumers about the exclusions that apply to their policies: see Figure 8.
- Consumers who apply for an underwritten policy and are rejected due to their medical history may choose a guaranteed acceptance product so that they have some level of cover.
- However, we are concerned that if consumers do not understand the scope and implications of a pre-existing condition exclusion, the product they have bought is unlikely to meet their needs and may not provide the cover they expect at claim time.
- These products can also be more expensive for consumers, despite offering more limited cover. In our call review, we saw consumers downgraded to guaranteed acceptance life insurance, where the quote for the guaranteed acceptance policy was much higher than the initial quote provided for the underwritten policy.

#### Case study 14: Higher premium for guaranteed acceptance policy

A consumer applied for a term life insurance policy with \$500,000 of cover and was quoted an initial premium of \$120.96 a fortnight for a fully underwritten policy.

The sales person then took the consumer through the underwriting questions and determined that they were not eligible for this policy.

The consumer was offered guaranteed acceptance term life insurance with a pre-existing condition exclusion instead, with the same level of cover, and a premium of \$197.69 a fortnight.

#### **Definitions of pre-existing condition**

- A consumer's ability to understand the limitations of a pre-existing condition exclusion are further reduced given the variety of definitions that firms use.
- Where a pre-existing condition exclusion applies, a term life or income protection claim will generally not be paid if death, illness or disablement was caused directly or indirectly by an illness, medical condition or related symptom that:
  - (a) was diagnosed or known about by the consumer;
  - (b) the consumer had sought or intended to seek medical treatment for; or
  - (c) a reasonable person should have been aware or would have sought medical treatment for.
- Apart from this core concept, there are a range of variations to the definition of a pre-existing condition that affect the breadth of this exclusion.
- Two firms in our review defined health factors such as a high body mass index, high cholesterol levels, high blood pressure and diabetes as symptoms that would be considered a pre-existing condition for various causes of death (e.g. heart attack or stroke).
- The length of time a consumer had symptoms or an illness before taking out the policy was also a factor in defining a pre-existing condition. For the term life insurance products we reviewed, symptoms or a diagnosed illness were considered pre-existing if they were present in the five years before the policy commenced.
- For income protection products this varied in some cases, with two firms applying shorter periods of two to three years.
- There was also variation in how long the exclusion applied after the policy commenced. While four of the firms in our review applied the pre-existing condition exclusion for the life of the policy, two firms applied a limitation to the exclusion of five years for their term life policies. That is, if the consumer kept the policy for five years without the pre-existing condition recurring, the exclusion would no longer apply to that specific condition.
- These varying definitions are particularly problematic given the number of consumers in our call review who were replacing another life insurance policy (see paragraph 203) as they may not realise that these different definitions can have a large impact on the breadth of their cover.
- Only two firms in our review did not have exclusions for pre-existing conditions in any of their products.

#### Claims outcomes

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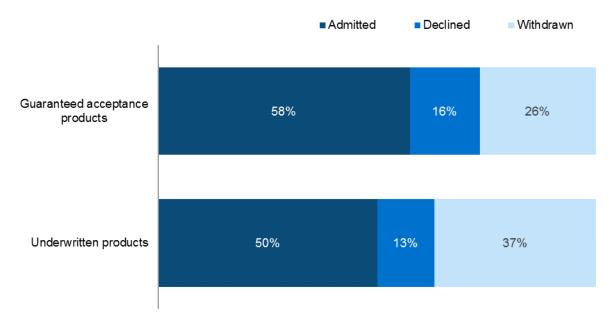
The PJC report (see paragraphs 133–134) noted that a possible reason for the higher declined claims rate for direct life insurance could be due to policies being underwritten at claim time and called on ASIC to provide clarity on this point, by including data on the 'connection between denied claims and underwriting practices in its review into the direct life insurance industry'.

Note: See the PJC report, p. 186, paragraph 10.168.

Claim outcomes for term life and income protection policies varied for the firms in our review when comparing underwritten and guaranteed acceptance policies, and this may be a contributing factor to higher declined claims in this distribution channel, though the difference is small enough that it is unlikely to be the sole factor.

While income protection claims did have a higher declined rate for guaranteed acceptance products (16% compared to 13% for underwritten), they also had a higher admitted rate (58% compared to 50% for underwritten). This was due to underwritten policies having a much higher rate of claims withdrawn (37% compared to 26% for guaranteed acceptance): see Figure 9.

Figure 9: Claims outcomes for income protection, guaranteed acceptance versus underwritten



Note 1: When considering finalised claims only (i.e. excluding withdrawn claims) in line with the methodology adopted by the APRA–ASIC claims data collection, guaranteed acceptance income protection policies have a declined rate of 22%, compared to 21% for underwritten policies.

Note 2: See Table 11 in Appendix 2 for the underlying data shown in this figure (accessible version).

Term life insurance claims had only one percentage point difference between guaranteed acceptance and underwritten products (16% and 15% respectively). However, acceptance rates were notably higher for claims made under an underwritten policy: see Figure 10.

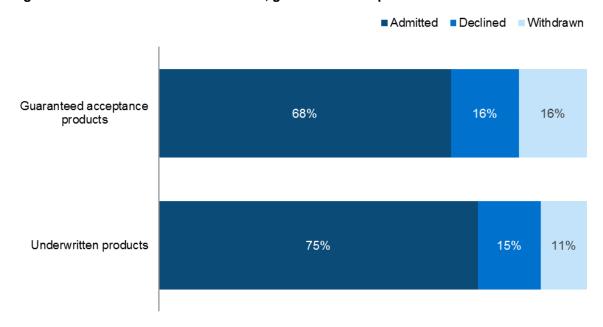


Figure 10: Claims outcomes for term life, guaranteed acceptance versus underwritten

Note 1: When considering finalised claims only (i.e. excluding withdrawn claims) in line with the methodology adopted by the APRA–ASIC claims data collection, guaranteed acceptance term life policies have a declined rate of 19%, compared to 17% for underwritten policies.

Note 2: See Table 12 in Appendix 2 for the underlying data shown in this figure (accessible version).

#### Accidental death insurance

- Accidental death insurance pays out a benefit to the beneficiaries or estate of the policyholder where death occurs due to an accident, but not because of illness. It is generally only sold through the direct channel.
- Of the eight firms in our review:
  - (a) one firm offered standalone accidental death insurance;
  - (b) two firms offered standalone accidental death insurance or the option to combine it with accidental injury cover; and
  - (c) two firms offered accidental death insurance with accidental injury and as an add-on to term life insurance.

#### Limitations of accidental death insurance

- Accidental death insurance offers a very limited benefit to consumers who are ineligible for any other type of life insurance.
- Accidental death insurance was the product in our call review where we had the greatest concerns about how it was sold—it was described poorly by all firms who offered it. This is particularly problematic as consumers were generally downgraded to this product, or it was bundled in with other cover, and they had not sought it out.

Further, accidental death cover that was sold with a term life policy did not appear to meet any consumer need, as the term life policy would provide cover for death due to accidents as well as illness and disease. We are particularly concerned where this cover was bundled into the sale without clear consent from the consumer (see paragraph 255(c)), resulting in the consumer paying a higher premium for additional cover that was unnecessary and unlikely to meet their needs.

The accidental death products that we reviewed provided very limited cover—for example, the definition of 'accident' referred to external physical forces being 'independently' or 'solely' the cause of death. This means that if a person dies as a result of multiple factors, even if it is partly due to an accident, a claim may be declined.

#### Case study 15: Surgery after an accident

A consumer suffered from a fall and went to hospital where she underwent surgery due to a fracture resulting from the accident. After being discharged from hospital following the surgery, the consumer died from pneumonia, which was determined to have occurred in the context of her surgery. The consumer had some other health issues which put her at a higher risk of contracting pneumonia.

The claim under the consumer's accidental death policy was declined because the accident was not the sole factor that contributed to her death.

Accidents make up a very small proportion of deaths in Australia. Data from the Australian Bureau of Statistics (ABS) indicates that of all the deaths that occurred in 2016, around 5% were as a result of accidents.

Note: See ABS, <u>3303.0—Causes of death</u>, <u>Australia</u>, <u>2016</u>. We calculated the proportion of accidental deaths by combining the number of deaths caused by anything other than illness, disease or self-inflicted injuries.

A further proportion of these would not be covered under an accidental death policy, as there may have been other contributing factors, or where drugs or alcohol were involved. Accidental death insurance excludes being under the influence of drugs or alcohol (including taking prescription drugs in a way that differs to medical instructions), or any self-inflicted injury.

Additional exclusions may include certain occupations, pastimes and sports, which further reduces the scope of cover.

#### **Consumer outcomes**

We are concerned that, based on the poor descriptions of exclusions and limitations we observed during sales calls, it is unlikely that accidental death insurance will perform in the way the consumer, their family or dependents expect at claim time.

358

360

43%

40%

- We obtained data from the firms in our review which found that the claims ratio for accidental death insurance for the 2015–17 financial years was 16.1%, meaning that for every \$1 of premium paid by consumers, only 16 cents was paid in claims by insurers: see Appendix 1 for our methodology.
- Given the limitations and exclusions of the policies, outcomes for claims submitted were also very poor, with only 26% of accidental death claims successful. This varied across insurers: see Figure 11.

Firm A 13% 43% 44%

Firm B 52% 33% 14%

Firm C 51% 14% 36%

37%

Figure 11: Claim outcomes for accidental death, by firm

Note: Three firms were excluded due to having fewer than 20 claims lodged during this period. One firm included in this figure, which was part of a bank, had a very high proportion of 'other claim outcomes' which were excluded from this analysis. This was due to an internal process of issuing claim forms to the estate when the bank was notified of a consumer's death, whether or not that death was known to have been accidental. This appeared to result in large numbers of claims for deaths that were not accidental.

30%

Note 2: See Table 13 in Appendix 2 for the underlying data shown in this figure (accessible version).

- The firm in our review with the most in-force accidental death policies also had the lowest successful claims rate. This firm had stopped selling accidental death insurance before our review commenced.
- Two other firms in our review also stopped selling accidental death insurance in 2017. One firm stated it stopped selling standalone accidental death insurance because the benefit can be obtained through term life insurance—which supports our concern that this policy does not meet a clear consumer need.

#### Increases in cost

Firm D

Firm E

20%

30%

- Direct life insurance can have different premium structures and other features that will affect the future cost of a policy.
- The cost of a life insurance policy can increase every year due to:
  - (a) 'stepped' premiums; and/or
  - (b) automatic indexation increases.

If consumers do not understand how these features work, they cannot take into account the future cost of different products and may end up buying insurance that they cannot afford in the long term. This may lead to policies lapsing when cover becomes unexpectedly unaffordable.

#### Stepped and level premiums

368

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Consumers do not necessarily understand that their premiums are likely to increase over time due to a stepped premium structure. Our consumer research found that 38% of consumers with life insurance that provided cover for illness (and was therefore likely to increase in cost over time) thought that their premiums would stay the same: see REP 588, p. 123.

Stepped premiums change based on a consumer's risk factors over time. This includes the consumer's age, which means that premiums typically increase each year. Level premiums are not based on the consumer's individual risk factors, which means they are more stable over the life of the policy but will be more expensive at the beginning: see Figure 12.

monthly premium

Stepped — Level

Figure 12: Stepped versus level premiums

Note: See paragraph 370 for a description of the trends in this figure,

- Although level premiums are more predictable over time, they can increase if the insurer increases premiums for all policies in a defined risk group.
- Of the firms in our review, two offered a choice of stepped or level premiums on some, but not all, of their policies. One further firm had one product that was available online which only offered a level premium.
  - These products represented only a small sample of the policies we reviewed—most direct life insurance policies had stepped premiums, yet our

373

age

consumer research shows that many consumers are not expecting this increase or are unsure how it will be determined: see REP 588, p. 48.

- Firms sometimes provide options for consumers who cannot afford a stepped premium increase in a particular year. Three firms in our review offered policies with stepped premiums, which had an option for the consumer to ask the insurer not to increase the premium in a certain year, or over several years.
- Under this option, the sum insured decreases instead. This may not be a long-term solution for consumers who cannot afford the premium increase, as it will gradually erode the level of cover that they have, to the point where it may no longer meet their needs.
- Stepped premiums may be an appropriate option for some consumers, who want short-term coverage, have decreasing financial obligations such as their mortgage, or are confident that they can afford substantial increases in the future. However, level premiums provide more transparency and certainty to those who want to ensure they can afford their life insurance over a long period of time.

#### Indexation

- Indexation increases are often referred to as 'cost of living increases' or 'inflation benefits'. Indexation is applied to life insurance to keep the sum insured in line with inflation by applying an automatic increase each year to ensure the level of cover does not decline in real terms.
- While this can benefit consumers by ensuring the level of cover they have will continue to meet their needs, the cost of the premium will also rise in line with the sum insured increase, which may impact affordability.
- Indexation increases were commonly applied to all the product types in our review—term life, trauma, TPD, income protection and accidental death.
- The amount of annual increases can vary between products. For example, we saw annual increases of:
  - (a) the higher of 5% or the consumer price index (CPI);
  - (b) the higher of 3% or CPI;
  - (c) 5% each year; or
  - (d) CPI each year.
- Only one firm did not apply an indexation increase to any of its products.
- Depending on how long a consumer holds their life insurance policy, the increase applied might far exceed CPI and the consumer's needs. Over the past decade, the annual CPI increase has been lower than 4%, and only exceeded 3% on two occasions.

Note: See ABS, <u>6401.0—Consumer Price Index</u>, <u>Australia</u>, <u>Jun 2018</u>, 'Past and future releases' for historical CPI increases; based on 'All groups, weighted average of eight capital cities, percentage change from previous financial year' from 2008–09 to 2017–18.

- While we recognise that indexation can help reduce the risk of underinsurance, automatically applying an indexation increase raises concerns about affordability. If the consumer is not aware of this increase or that they can opt out of it, the rise in premium might result in their policy lapsing or may prompt them to seek other more affordable cover. As discussed earlier, this can result in poor outcomes for consumers: see paragraphs 203–208.
- All of the policies we reviewed allowed consumers to opt out of indexation increases. However, some firms made this process unnecessarily difficult for consumers. For example, three firms required written notification by post to the insurer each year to opt out. It is difficult to characterise this as anything other than a deliberate tactic to make it difficult for consumers to opt out of indexation increases.
- Some insurers allowed consumers to opt out of an indexation increase for one year only or indefinitely, giving them an easier process if they knew they did not want the increase applied each year.
- We are particularly concerned about indexation for income protection insurance where there are limitations on the amount a consumer can claim based on their income (e.g. 75% of income after tax). This creates the risk that the consumer is paying for more cover than they can ever claim for.
- Five insurers had income protection policies with automatic indexation increases that could exceed what the consumer was eligible to claim under the policy. In some cases, the PDS recognised this risk, but put the onus on the consumer to review the annual increase each year, determine whether the increased amount exceeded what they could claim, and take steps to opt out of the increase.

#### Low-value features

- Our call review found that certain product features or add-on benefits were promoted heavily or cross-sold by sales staff during calls. Some features were automatically included in a policy and were promoted while discussing the cover to differentiate the product from competitors, while other add-on benefits were offered to consumers for an extra cost.
- It was not evident that these features or add-on benefits met a genuine consumer need or offered good value for consumers.
- The high number of additional benefits or features associated with some products appeared to be in part a response to ratings by research firms and industry awards, with firms designing products that would score well (rather than being necessarily designed with specific consumer needs in mind).

- We also observed sales staff suggesting to consumers that they were being offered a free benefit or given special treatment, for example, by:
  - (a) emphasising 'free' or 'extra' benefits in the policy, even where these added little or no value compared to the cost of the policy; and
  - (b) using statements such as 'you have been pre-selected for ...' or 'you have qualified for...' or 'congratulations...' that make it appear that the consumer is being offered something special, when in fact the product was for general sale.

#### Age benefits

- Seven firms in our review offered a range of 'age benefits' with term life and accidental death insurance, which provide cover for longer than other life insurance policies or provide guaranteed payouts at a certain age.
- While these features may give consumers an additional benefit, we were concerned by the substantial limitations of these features which were not often highlighted by the firms:
  - (a) Three term life products with level premium options provided cover beyond 65; however, the level premiums became stepped, which may become unaffordable for the consumer.
  - (b) One accidental death product reduced the benefit by half when the consumer reached 80.
  - (c) One policy had a guaranteed payout to the consumer at 85, and another policy had no age limit at all; however, they both only offered stepped premiums, which meant consumers were likely to struggle to afford the policy for that long.
- In our call review, we heard some of these features promoted heavily. For example, two firms mentioned these features early in the sales call as a key benefit of the product but failed to highlight the limitations.
- With guaranteed payouts, people may be persuaded to hold onto cover beyond their needs or affordability because of 'sunk costs'; in these cases, firms should ensure they explicitly advise consumers that they could pay more in premiums than they will ever receive.
- We are also concerned that the cost of the policy may increase substantially at a time when the consumer is likely to have a reduced income due to retirement.

  Consumers may be 'priced out' of their cover when they expected to hold it much longer, particularly if they have previously been on level premiums.

#### Children's insurance

- Optional children's insurance was offered by six of the firms in our review.

  This cover was always sold as an add-on benefit to a main policy, which was usually a term life or income protection insurance policy.
- The cover varied between policies and the type of cover often did not align with the main policy benefit. Examples included:
  - (a) term life insurance with children's insurance that provided cover for accidental death and eight specific trauma events (e.g. cancer, loss of sight, paralysis); and
  - (b) income protection insurance with children's insurance that provided cover for eight specific trauma events (e.g. permanent loss of the use of two limbs, encephalitis, major head trauma).
- This misalignment between what the consumer is being covered for and the limitation of the cover offered by the children's insurance may mean the policy does not provide the cover expected at claim time.
- In our call review it was evident that some consumers seemed to not understand the purpose of children's insurance—in one call it became evident that the consumer thought the children's insurance was the process of leaving her life insurance payment to her children.

#### Case study 16: Confusion about children's insurance

The consumer was purchasing term life insurance, and the sales person asked whether she had any children aged between two and 17. The consumer confirmed she had one—a seven-year-old—and a baby who was only seven months old.

The sales person said, 'You can add them on to your policy until they reach 21, or if you want to wait until your younger child reaches two, you can add them on at the same time—would you like to look into the children's cover now, or maybe later?'

The consumer said that this is what she wanted the cover for—that this is what she was mainly setting it up for. The sales person said they could add the older child for now.

As they were discussing the details, the consumer asked, 'So how does it work, do I put an adult's name on there so that the money goes to an adult, and then they separate the money between my kids?'

The sales person established that the consumer was talking about her beneficiaries; he explained that he was offering cover for her children if they had a serious illness. The consumer confirmed she did not want cover for her children.

Two firms offered children's insurance in a way that was more directly linked to the main insurance benefit and where the purpose was clear. These two firms offered the cover with income protection insurance and the consumer could claim the children's benefit if they had to take time off work

to care for a dependent child over an extended period of time (e.g. beyond standard carer's leave entitlements). In these cases, the child did not have to suffer from a specified illness or injury; the key event was the need for the parent to take time off work.

In other instances, it was unclear whether children's insurance met a clear consumer need. Some children's insurance provided a lump sum payment for accidental injuries or serious illness in such limited circumstances that it is very unlikely the cover would meet the parents' needs. For example, one policy only covered extremely serious injuries, such as total loss of hearing or sight, or paralysis – and only where the injury was as a result of an accident, rather than resulting from an illness or disease.

Where children's insurance provided payment for accidental death, it is also unclear how this would meet a financial need. Life insurance traditionally provides for an individual's dependents to cover debts or future living expenses—a child has no debts and no income that is relied upon. The cover is also limited to accidental death only; therefore, it will not cover the costs for expenses, such as a funeral, if the death is due to illness or disease.

Based on how children's insurance was sold in our call review, we expect that this product is often bought by consumers based on an emotional response, rather than consideration of their financial needs. Sales staff would sometimes ask a consumer if they would like to 'cover their children' as well, creating a sense that in buying this cover the consumer is protecting their child.

#### Design and distribution obligations

Firms should ensure that products are designed with clear consumer needs and consumer understanding in mind, and firms should monitor whether products perform in line with expectations.

The financial product design and distribution obligations being introduced will place a formal obligation on firms to establish needs, design products with a clear target market in mind, and distribute them accordingly. Firms will also be obliged to conduct regular reviews of product performance.

Our review identified several ways in which firms should strengthen their product design processes.

Firms should identify a clear target market for their products; they should also be clear which consumers are unlikely to benefit from a product and who are therefore outside the target market. This should inform distribution strategies and sales processes, including guidance for sales staff. The firm in our review that did this best had identified a very clear and quite narrowly defined target market and used distribution strategies designed to reach these consumers. This appeared to translate into good conduct at point of sale and good performance on consumer outcomes.

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407

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- Firms should benchmark the design of their products against other firms' products, and where they have, for example, a particularly broad exclusion or are otherwise out of line with industry, they should take steps to ensure consumers understand this.
- Firms can do more to understand their customers, how they behave and the challenges they face. Research that highlights what consumers struggle with—including the consumer research in REP 588—can help firms to identify areas for improvement.

#### Recommendation 8: Ensuring products meet consumer needs

- Some direct life insurance products or their features are limited in value or may not perform as consumers expect.
- The Code should introduce obligations for establishing clear target markets, particularly for limited value products, and for firms to only sell these products where there is genuine consumer need.
- Firms should review products and features that are unlikely to meet consumer needs, including the following:
  - (a) Accidental death insurance—The substantial limitations of accidental insurance mean that it is unlikely to meet consumer needs. Firms should consider whether this product offers real value to consumers and should stop selling this product unless they can demonstrate that it provides value and meets a genuine consumer need.
  - (b) Automatic indexation increases—Automatic indexation can substantially increase the cost of a policy over time. Firms should make the process of opting in or out of indexation as clear and easy as possible. Firms must ensure that automatic indexation increases do not result in the consumer paying for more cover than they could ever claim.
  - (c) Low value features—Firms should limit the inclusion and promotion of low value and complicated product features. Firms should review such features against how they meet a genuine consumer need and not include them if they do not serve a clear purpose or if they offer poor value. For example, an age benefit such as 'guaranteed payout' is unlikely to perform as expected when it has stepped premiums which are likely to make the cover unaffordable before the payout age is reached.

#### ASIC action 4: Monitoring accidental death insurance

We will monitor consumer outcomes for accidental death insurance, including rates of cooling-off cancellations, short-term lapses, and claims outcomes. If we remain concerned about poor consumer outcomes and poor sales practices, we will consider using our current, and proposed future, powers to intervene.

# E Training and scripts

#### **Key points**

Some firms' training and scripts included sales practices that we identified in our call review as problematic and likely to increase the risk of poor consumer outcomes. In some cases, training on appropriate sales conduct was not clearly articulated or appeared conflicted, meaning sales staff might not be sure about what is unacceptable conduct.

On the positive side, training on product knowledge was generally very thorough and comprehensive, and most firms' training covered key compliance requirements in detail.

However, scripts sometimes failed to include clear guidance on conversations about product exclusions and future cost, which may have contributed to some of the poor conduct we observed in our call review.

Firms should emphasise in their training the risks to consumers and the impact on them and their families if life insurance does not perform as expected—only one firm in our review did this. This will help sales staff to recognise the importance of their role in providing consumers with appropriate information and time to make an informed decision.

- We reviewed training material and sales scripts to identify whether they contributed to sales behaviour that increases the risk of poor consumer outcomes, including consumers buying insurance that they do not understand or does not meet their needs.
- We considered whether key compliance elements were addressed through training materials and scripts, however, our focus was broader than strict legal obligations. Our review focused on whether training and scripts were likely to equip sales staff with the tools and knowledge to assist consumers to make informed decisions when buying direct life insurance.

# Sales practices

Training and scripts are an opportunity for firms to establish good foundations for future conduct by setting clear behavioural expectations and providing scripting and guidance to reduce the risk of inappropriate sales conduct.

#### **Establishing appropriate conduct**

Given some of the concerning sales conduct we identified in our call review (see Section C), we reviewed training materials and scripts to determine whether firms were providing clear guidance to sales staff on acceptable conduct, or if they were guiding staff to engage in inappropriate sales tactics.

- Six firms in our review had training that incorporated sales tactics that could lead to poor consumer outcomes (e.g. objection handling, cross-selling and downgrading cover).
- Four of these firms also had scripts that guided sales staff to engage in pressure selling or other inappropriate sales conduct, such as:
  - (a) using the cooling-off period to induce a sale;
  - (b) handling objections, including one firm that required staff to manage a minimum of two different objections before ending a call;
  - (c) not pausing during certain points of the script, which means the consumer does not have an opportunity to interrupt or say no;
  - (d) upselling and cross-selling (e.g. by providing the consumer with a quote for additional cover that they have not asked for or offering a long list of add-on products); and
  - (e) selecting the cover type or sum insured for the consumer.
- The four firms with training and scripts that included inappropriate sales practices were the same four firms who engaged in pressure selling in our call review, demonstrating a clear link between standards established through training and scripts, and staff conduct.
- As mentioned earlier (see paragraph 228), it is particularly concerning that some firms have incorporated these techniques into their scripts, given that we discussed similar concerns with consumer credit insurance in REP 256 in 2011 and made specific recommendations about sales scripts.
- By comparison, one firm had instructions incorporated into its scripts telling staff to immediately end a sales call if the consumer indicated they were not interested. Establishing clear standards in this way appeared to be effective as we did not see any explicit pressure selling by this firm in our call review.
- While the Code commits members to develop sales rules to prevent pressure selling, it does not explicitly define pressure selling, so insurers apply their own interpretation of what is or is not pressure selling.
- Our review of training materials found that firms did not always articulate this clearly, or they set conflicting expectations of staff.
- Although staff were trained not to pressure sell, three firms had training materials that taught staff to engage in objection handling or 'closing' techniques and did not provide clear explanations of when these techniques might constitute pressure selling. This is likely to result in sales staff not knowing what behaviour is unacceptable, in turn leading to poor sales conduct and poor consumer outcomes.

- Two firms had developed very clear guidelines about inappropriate sales. However, we did not see this reflected in the calls, possibly because:
  - (a) the guidelines did not feature heavily if at all in the training, and
  - (b) sales staff were also instructed to use closing techniques that in some instances contradicted or undermined the impact of the guidelines.

#### Case study 17: Training on objection handling techniques

One firm's training provided sales staff with scripts for suggested 'objection handling' responses to consumers. One potential objection from a consumer was that they already had life insurance through their superannuation fund. The objection handling response included asking the consumer whether they had answered any health and lifestyle questions for that policy, and whether they knew about potential tax implications for payouts when life insurance is held through superannuation.

This technique was used in a sales call where the consumer initially seemed to want health insurance but had unintentionally sought a quote from a life insurance company instead. The sales person said they could offer life insurance, but the consumer said they already had life insurance through their superannuation.

The sales person indicated that because the consumer had not answered any health or lifestyle questions when applying for that policy, it could be a 'default' and may not pay out at claim time, or there could be a dispute about the cover which could drag out the process of getting a claim paid. The sales person also suggested that tax implications meant their beneficiaries could be taxed at 30% or 40%.

During the call, the consumer indicated again that they really wanted health insurance and did not have the budget for life insurance. However, the sales person 'objection handled' these concerns again, in line with the training and scripts.

The consumer was subsequently convinced by the sales person to apply for a term life insurance policy. He was then declined for that policy and downgraded to accidental death cover instead.

#### Vulnerable consumers

- To help vulnerable consumers, sales staff need clear guidance on:
  - (a) indicators of potentially vulnerable consumers; and
  - (b) practical steps to take if they identify that they are engaging with a potentially vulnerable consumer.
- The Code sets out standards for helping consumers who may need additional support. These are vulnerable consumers who may require more assistance to make an informed decision due to language difficulties, comprehension, financial limitations or other reasons.
- All firms in our review had some form of training on vulnerable consumers, either standalone or as part of their training on the Code, and in some cases

the training and guidance was extensive. For example, two firms in our review had comprehensive guides for identifying and responding to vulnerable consumers.

However, not all firms' training recognised a consumer's financial status as an indicator of vulnerability. In one case, while the firm's training recognised financial vulnerability, staff were still trained to sell to consumers who were concerned about affordability.

#### **Case study 18: Targeting low-income consumers**

One firm had multiple sales calls in our review where consumers stated that they could not afford life insurance or were receiving unemployment benefits, indicating that the consumer may have been financially vulnerable. The firm's sales script recognised that this was common for their consumer base—in the script for sales staff to ask for a first payment date they were told to say, 'Now most customers prefer to line this up on a pay day or pension day ... So what day do you normally get paid on?'

The firm's training also identified consumers receiving a 'support pension' as potentially vulnerable, but still trained its staff in these instances to use objection handling for 'up to two objections and on the third objection you must let the customer go and arrange a call back'.

In the calls that we reviewed, consumers who stated they could not afford a product were pressured to buy. In one instance, when a consumer stated that she could not afford life insurance because she had a lot of money going out to bills and other expenses at the moment, the sales person responded by stating, 'At the end of the day, if you're paying all these bills and something was to happen to you, who's going to look after those bills?'

Later in the call the consumer said she did not want to sign up yet as she already had funeral insurance and she had no money in her account at all. The sales person persuaded her to buy by pushing the payment date back a few weeks.

Overall, we did see positive conduct in our sales call review in the handling of vulnerable consumers, however we also observed instances where sales staff failed to identify and address indicators of vulnerability or a lack of understanding by the consumer: see paragraphs 279–281.

# Product knowledge

- All the firms in our review had comprehensive training materials covering the details of the products they sold, including product structure, benefits, the amount of cover available, eligibility and exclusions.
- A brief, clear description of the product benefits and what it covered had also been developed and incorporated into the scripts, or the script referred the sales person to the relevant section of the PDS. This was reflected in our

sales call review, with descriptions of product benefits being an area where we saw generally good practice.

- However, the product limitations and exclusions that were detailed in training materials were not often reflected in sales scripts. Scripts generally included only a broad statement about exclusions, sometimes mentioned one or two examples of exclusions, or simply directed the consumer to read the PDS, placing the onus on the consumer to ask questions in order to get more specific information.
- This was reflected in our sales call review, where we identified poor descriptions of exclusions, including pre-existing condition exclusions (see paragraphs 184–192), and the consumer research reflects the impact on consumer outcomes, with 66% of consumers unaware of the exclusions that applied to their policy: see Figure 8.
- This is a missed opportunity, as our consumer research also shows that many consumers place a lot of importance on what they are told by sales staff: see REP 588, pp. 28–30.

# Compliance

- All firms in our review had training materials and scripts that addressed basic compliance requirements for sales.
- Training materials covered key compliance requirements including the difference between personal and general advice, or no advice, and the need to avoid unconscionable conduct, and misleading and deceptive conduct. Four firms did this particularly well, providing examples and case studies to make the application of the law easier to understand.
- For example, some firms used examples to show how a sales person might accidentally cross the line into personal advice, and how they could avoid this but still provide the consumer with helpful information and guidance.
- All the scripts incorporated mandatory disclosures as required, including the duty of disclosure warning and the general advice warning.
- We identified one firm that failed to include all relevant eligibility questions at the beginning of the script, before offering an income protection product that had requirements relating to hours worked per week and self-employment. Instead, this firm scripted a warning towards the end of the sale, notifying the consumer of these eligibility requirements.
- This firm had a similar process for their online sales (see paragraph 314(a)) and has since advised that it is changing both processes to incorporate eligibility questions at the beginning of the sales process.

# Highlighting the impact on consumers

- While training materials and scripts addressed basic legal requirements for selling direct life insurance, they rarely focused on the challenges for consumers in understanding and buying the right policy, and the impact on them and their family if they fail to do so.
- Product features and limitations were explained to staff; however, the impact of a consumer not receiving or understanding this information was only reflected in one firm's training materials.
- For example, the potential broad limitations of a guaranteed acceptance life insurance product (see paragraphs 321–347) could mean a consumer's family cannot make a successful claim if the consumer dies of a pre-existing condition. If this was not clearly explained, the consumer may not understand the breadth of the pre-existing condition exclusion and would probably assume their family is protected.
- The declined claim in such circumstances would have significant repercussions—for example, a family would be dealing with the stress of a declined claim at an already difficult time and may lose their home.

  Explaining such risks with case studies that clearly show the potential consumer experience and outcome would help sales staff understand the importance of their role.
- Rather than giving sales staff a clear example like this, four firms focused on the potential business risks. In one instance, the test that sales staff had to complete after training showed a lack of consideration for the consumer and highlighted that the purpose of the training was to minimise risk to business.

#### Case study 19: Focus on risks to the business

In a test that sales staff had to complete after training, one question asked what risk to the business was created by not attempting to advise a consumer of the relevant exclusions.

The correct answer was, '... if they lodge a claim due to an excluded event, we may have to pay out the claim'.

This scenario did not recognise that the consumer or their family would be relying on cover that does not meet their needs— they might only realise they are not covered when an event occurs and may never lodge a claim, or they may have it declined.

While we recognise the importance of staff understanding the risks to a business if they breach compliance obligations, framing compliance obligations mostly in terms of business risks suggests that the consumer is not really at the centre of the sales process.

We consider it is just as important for sales staff to understand the consequences of selling a policy that a consumer does not want, understand, or cannot afford. If sales staff have training that considers consumer outcomes, they will understand the impact of their conduct during sales calls, and how they can influence consumer understanding and outcomes.

# Recommendation 9: Establishing conduct standards through scripts and training

- Training and scripts give firms an opportunity to set behavioural standards and expectations for sales staff. Firms should not train staff to engage in practices that create the risk consumers will feel pressured during the sale.
- 452 Additionally, sales scripts:
  - (a) should not incorporate pressure selling tactics, or other sales tactics that reduce the consumer's ability to make an informed choice; and
  - (b) should incorporate clear instructions for ending a call when a consumer indicates the first time that they do not want to continue with the sale.
- Firms should also incorporate the consumer's perspective into training (e.g. by including case studies showing the impact on a consumer and their family if they are given inadequate information about policy exclusions or price increases).
- Firms should also build on the existing provisions in the Code and set clearer expectations around how sales staff should behave when dealing with vulnerable consumers, including when it will be appropriate to end a call.

# F Quality assurance

#### **Key points**

Quality assurance frameworks play a key role in monitoring sales conduct, identifying and resolving sales problems, and acting as a deterrence for poor conduct.

In general, firms' frameworks were not fully effective because they:

- did not consistently test for behaviours that were likely to increase the risk of poor consumer outcomes (as identified in our call review); and
- in some cases, had very low thresholds for passing assessments or did not strongly penalise failure, limiting the consequences for sales staff where poor sales conduct was identified.

Our review of quality assurance assessments completed by firms supported this finding—only 10% of the 29 assessments identified the issues highlighted by our call review. While all firms took a risk-based approach to sampling, this did not always include calls likely to pose the greatest risk to consumers but was often designed to minimise risks to the business. Sample sizes were sometimes so small that it was unlikely the firm could monitor conduct effectively.

It was not always clear whether issues identified in assessments were followed up with consumers in a consistent and timely manner. More often, the sole output appeared to be feedback to sales staff or corrections to underwriting, rather than identifying poor consumer outcomes.

- We reviewed the quality assurance frameworks of the firms in our review to understand whether they were likely to be effective.
- We expect an effective quality assurance framework to allow firms to:
  - (a) monitor whether conduct is compliant with the law and regulatory expectations and does not create the risk of poor consumer outcomes;
  - (b) promptly identify instances where it might be necessary to contact a consumer to rectify an issue; and
  - (c) highlight areas where improvement in conduct of sales staff, or the operation of systems or processes, is needed.
- An effective quality assurance framework should also act as a credible deterrent against misconduct.
- We tested how quality assurance frameworks performed in practice by comparing all eight firms' assessments to our assessment of the sales calls in our call review.

# Identifying poor conduct

- Quality assurance assessments were designed to test for conduct including:
  - (a) compliance with relevant laws and conduct standards;
  - (b) adherence to business rules and process requirements;
  - (c) consumer experiences; and
  - (d) in some cases, effective use of sales techniques to close a sale.
- Firms' frameworks were designed to test compliance with important regulatory requirements. Often this was done by checking that sales staff adhered to mandatory scripting to describe product cover and exclusions or give important warnings to the consumer.
- However, we identified significant gaps in other areas of the frameworks. For example, they were not designed to test for a number of behaviours that we identified as problematic in our call review.
- This was reflected in the actual assessments we reviewed. Of these 71 assessments, 29 were for calls where concerns were identified in our sales call review. Of these 29 assessments, 90% did not identify our key concerns
- Firms had not identified the risk of giving poor explanations about key exclusions and future cost. Given that these risks had not been identified, the frameworks were not set up to test for these issues, and in practice assessments did not identify these problems.
- While firms sought to test for inappropriate sales conduct, including pressure selling, we found that the frameworks were not well designed to identify such conduct. This was reflected in actual assessments; in 18 sales calls where ASIC identified pressure selling, only one quality assurance assessment identified this conduct.
- We identified several reasons for this, including:
  - (a) a lack of clarity over what constituted pressure selling or other forms of inappropriate sales behaviour;
  - (b) overly complex sales rules (e.g. for objection handling); and
  - (c) conflicting pressure placed on sales staff, who were sometimes also assessed on how well they applied persuasive sales techniques or handled objections.
- In some cases, pressure selling was explicitly prohibited, but the lack of clarity about what constituted pressure selling meant that the framework was ineffective at identifying this conduct.

#### Case study 20: Lack of clarity about pressure selling

One firm's framework tested for both pressure selling and 'application selling', with evidence of either resulting in the sales person immediately failing the assessment.

However, the firm described pressure selling only in very general terms that gave no clarity about what it was.

Application selling was also not defined in any materials we reviewed. It appeared to be focused on sales where sales staff used the cooling-off period to close a sale but did not include the use of deferred payments to close a sale where the consumer is uncertain, which effectively pressures the consumer in the same way.

In practice, our review identified 24% of calls where the deferred payment option was used to close a sale, highlighting the practice was clearly widespread. We reviewed nine quality assurance assessments where we had identified problems with pressure selling and use of deferred payments, but only one assessment identified this conduct as problematic. This suggests that standards were not effective.

The strength of this firm's framework in actively testing for pressure and application selling was reduced by the lack of clarity about these practices. We are also concerned that use of deferred payments to induce a sale was not considered pressure selling.

- While all frameworks checked that the consumer had consented to buy a product, only two of the frameworks assessed whether the consumer was identified as vulnerable. If vulnerable consumers have agreed to buy a product, it may be without a clear understanding of what they agreed to, or because they felt pressured.
- Some conduct which increases the risk of consumers buying products they do not want or need appeared to be encouraged by the frameworks. Five firms assessed how the sales person had sought to secure the sale (e.g. whether the sales person had objection handled enough times or used other persuasion techniques). Two firms also assessed whether staff had taken opportunities to cross-sell additional products.
- Incorporating a review of sales techniques into quality assurance assessments is not in line with using this process to ensure that calls promote consumer understanding and deliver good consumer outcomes. It can also create conflicting messages for sales staff (e.g. where a failure to objection handle is penalised more severely than consumer-focused criteria).
- All firms' frameworks included a focus on the consumer's experience during the call. However, a lot of this was focused on testing customer service type measures, such as politeness and tone, rather than conduct that encourages informed decision making.

- While most firms attempted to include consumer understanding in the assessment, this was generally done in a formulaic way. For example, by asking the consumer if they understood, without testing for other indicators that the consumer did not understand what they were buying.
- Only a small number of firms tested explicitly for behaviour that might improve consumer understanding, such as listening skills, allowing for questions and answering them correctly.

# Timeliness of assessments and fixing problems

- Some firms carried out assessments as soon as possible after a sale had taken place, and generally within 24 hours. Other firms took longer, with calls not being assessed for several weeks in some cases.
- We are concerned that where firms wait several days or weeks to conduct assessments, problems are not identified and fixed in a timely fashion. This could lead to consumer harm where a sales person continues to engage in the same poor conduct or where a consumer has been sold a policy that does not meet their needs. In one instance, one firm had conducted 19% of their assessments 30–60 days after the call.
- Not all firms provided clear information on how they address shortcomings identified during calls, or if they do so consistently where an assessment identifies sales practices that increase the risk of poor consumer outcomes.

# Case study 21: Failure to punish poor conduct and follow up with consumers

We reviewed several quality assurance assessments for one firm where it was noted that the sales person did not notify the consumer that they would not be covered for any pre-existing conditions. While some calls resulted in formal warnings, others were still marked as having passed the assessment despite this key omission.

The feedback sheets did not give any indication of what follow up action was required to clarify this with the consumer and ensure they still wanted to proceed with the purchase. In some cases, the feedback sheet simply stated that the sales person should do better next time, without stressing the seriousness of this omission.

Conversely, clear processes and procedures were in place to fix errors that increased risk to the insurer, such as incorrect recording of responses to underwriting questions.

## Passing assessments and the use of sampling

- To be effective and act as a deterrent, an assessment should set high standards, with appropriate sanctions for failing to meet expected standards.
- Sampling allows firms to target calls that pose the highest risk of poor conduct, making the overall process more effective and increasing the chance of resolving issues quickly.

### Scores and pass marks

- All firms allocated points to individual elements of the assessment template, with points deducted from an overall score if sales staff did not meet the criteria.
- Firms then gave each sales call an overall score. In some instances, this resulted in individual calls being deemed to pass or fail; in others the percentage contributed to monthly or fortnightly averages, or the points accumulated in each call would be added up over the assessment period.
- An effective scoring system will have a challenging target or pass mark, where a broad range of poor conduct will result in an immediate fail.

  Comparatively, a scoring system will be weak if it has a low pass mark or multiple breaches must occur before a sales person can fail the assessment.
- Five of the eight firms set tough targets—one had a pass mark of 95%, and four had 90%. For most of these firms, a single significant breach could mean a failed assessment. Other firms' targets were weaker. For example, one firm had a pass mark of 85%. Another had a pass mark of 69%.
- In some firms' frameworks, sales staff could fail a significant number of criteria before they were deemed to have failed the call overall. This approach is acceptable for criteria relating to superficial issues (e.g. using the wrong greeting for the time of day) but is problematic if it relates to inappropriate sales conduct.
- While all firms had automatic fails for legal compliance, it appears that sometimes this did not capture very problematic conduct. In some cases, sales staff had passed the assessment even though they failed to read a key part of the script about significant exclusions such as pre-existing conditions. We only saw a few instances of firms specifically highlighting that breaches of consumer-focused criteria (e.g. pressuring the consumer or providing incomplete information about the product) would result in an automatic fail.
- Rather than have a pass or fail mark for individual calls, one firm assessed quality assurance performance based only on a demerit point system.

#### Case study 22: Demerit point system

One firm allocated a fixed number of demerit points for different types of conduct. As with a driving licence, these points would accumulate over multiple assessments, and penalties would apply after a sales person had accumulated a certain number of points. Points would be removed when the sales person had a 'clean record' for a certain period of time.

Such a system can be effective, in that the consequences of poor conduct are potentially felt for longer. However, under this framework a sales person could not accrue enough demerit points in a single assessment to trigger immediate penalties or other consequences, which reduces the effectiveness of the individual assessments. In addition, this firm assessed only a small sample of calls, meaning that sales staff were less likely to accumulate penalties and face sanctions.

#### Feedback and penalties

- All firms provided detailed feedback to sales staff based on quality assurance assessments. In most instances, the feedback highlighted what mistakes had been made, but this generally did not include what the implications of the error for the consumer might be. As discussed in paragraphs 444–450, firms should do more to communicate the potential impact of poor sales conduct on consumer outcomes.
- The most effective feedback we saw included explanations of what risks the behaviour had created, for example to the consumer, to the firm and brand, and to the sales person. However, only two firms had examples of this.
- All firms had systems in place for further training to address issues identified in quality assurance assessments.
- Other consequences for sales staff included:
  - (a) reduced or no commission;
  - (b) poor performance ratings which could affect bonuses, pay rises and career progression;
  - formal performance management, such as performance improvement plans, formal warnings and dismissal in the case of sustained poor conduct; and
  - (d) having to come in early to work for additional training.
- While the penalties we reviewed appeared broadly appropriate to deter poor conduct, we observed different practical outcomes. For example, one firm had provided written warnings for repeated poor performance, resulting in certain sales staff being dismissed. By contrast, a number of sales staff in another firm failed quality assurance assessments over several months, suggesting a lack of effective action against very poor performance.

#### Use of sampling

Overall, we observed a substantial difference in the proportion of calls that firms reviewed. One firm conducted quality assurance assessments on all sales calls. All other firms sampled a selection of calls, using a risk-based approach.

We asked firms to provide the proportion of assessments completed during July 2017, for all direct life insurance sales over the phone. Some firms had an overall proportion for all of their sales, while others measured this based on different categories or types of cover. The substantial differences in sampling were evident across the firms during this period: see Figure 13.

Firm A All covers 25% Firm B 15% All covers Firm C All covers 9% Firm D All covers 20% 23% ш Cover 1 Firm Cover 2 11% Cover 3 34% 89% Cover 1 ш Firm Cover 2 85% Cover 3 45% Cover 1 10% Firm ( Cover 2 7% Cover 3 4%

Figure 13: Proportion of sales calls assessed for quality, July 2017

Note 1: One firm was excluded as they had fewer than 10 sales calls during the period and had assessed all these calls. Note 2: See Table 14 in Appendix 2 for the underlying data shown in this figure (accessible version).

While most firms had minimum requirements ranging from two to four calls per sales person per fortnight, one firm's minimum requirement was only two calls per sales person per month. This sample is so small as to raise doubt about the effectiveness of the quality assurance framework.

- Some firms differentiated between products when targeting calls for review, or prioritised fully underwritten sales, either assessing all or a very high proportion of underwritten sales. These firms reviewed a lower proportion of calls that involved limited or no underwriting.
- This approach suggests that firms primarily use quality assurance assessments to minimise impacts on the business, by focusing on the risks of inaccurate underwriting, such as having to pay a claim for an existing condition that was declared by the consumer but not recorded appropriately.
- Sales of guaranteed acceptance products do not create the same risk to the insurer, but do pose a greater risk of poor consumer outcomes because of their broad exclusions and low levels of consumer understanding: see paragraphs 321–365. By reviewing a smaller proportion of these sales, firms deprioritised the risk of poor consumer outcomes.
- We welcome some of the elements of the risk-based approach that firms had implemented. This included sampling a higher proportion of:
  - (a) sales calls conducted by new sales staff or recent 'poor performers';
  - (b) high value calls that could indicate the sales person had encouraged the consumer to buy high levels of cover to increase their commission; and
  - (c) calls that were outliers to 'average call times', where quick calls may indicate the consumer was not engaged, or long calls suggest that the sales person persisted with the call over a long time where the consumer was objecting to the sale.
- In other areas, firms' risk-based frameworks were lacking. For example:
  - (a) only one firm increased the assessment of sales staff making the most sales; and
  - (b) none of the firms targeted calls that triggered additional commission—for example, the call that made a sales person eligible for commission or increased their commission rate significantly (see paragraphs 524–546).

# Independence and conflicts of interest

- In seven of the eight firms, quality assurance assessments were the responsibility of dedicated staff who were not part of the sales team and had independent reporting lines to the sales function they were assessing.
- Quality assurance staff had performance targets for the number of assessments they had to complete in any given period, but they were not penalised or rewarded based on the outcomes of the assessments. In that respect, we considered there was a low risk of quality assurance staff being subject to conflicts of interest in carrying out their job.

However, in one firm, sales team leaders carried out the quality assurance assessments. Part of the team leaders' variable remuneration depended on the performance of their team members in terms of quality assurance and soft skills. This firm also had a framework that allowed team leaders to use their judgement when deciding whether sales staff had performed in line with firm values and delivered a good consumer outcome.

While some discretion in assessing performance can be positive, this arrangement creates a conflict of interest. This firm has since removed this conflict of interest.

#### Recommendation 10: Strengthening quality assurance frameworks

Quality assurance frameworks should test for behaviour that creates a risk of poor consumer outcomes. Firms must establish clear standards for sales conduct and establish quality assurance assessments that specifically test for these obligations. The Code should mandate appropriate sales conduct and also that quality assurance assessments test for adherence with these standards.

When designing a risk-based quality assurance framework, firms should not just focus on sales which pose a business risk (e.g. fully underwritten sales which demand greater accuracy from sales staff). They should consider which sales have a higher risk of poor consumer outcomes (e.g. sales of guaranteed acceptance products with pre-existing condition exclusions). This should include sales which have a higher risk of misconduct due to incentives (e.g. calls that are likely to result in the sales person achieving a particular bonus or target).

Quality assurance frameworks should be better designed to punish poor conduct, and firms should set tough pass marks. Firms must also introduce ambitious minimum sampling targets that ensure that the quality assurance framework is effective in picking up problems and acting as a deterrent.

Assessments must be conducted within a short timeframe of the sale. Firms should also have effective measures in place for acting on the findings of quality assurance assessments, by addressing any issues with the consumer or making changes to their own systems and processes in a timely manner. Additionally, frameworks should test whether sales staff identified and responded to vulnerable consumers.

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# G Targets, sales incentives and performance management

#### **Key points**

Most firms had incentive schemes that included features designed to drive sales, such as minimum sales targets, and commission or bonuses calculated in some part based on the number or value of sales. These features create conflicts of interest, as they encourage sales staff to put their own interests, namely closing a sale, ahead of the consumer's interests.

Firms attempted to mitigate these conflicts of interest—for example, by using balanced scorecards, introducing quality assurance targets, and putting clawback in place. While these features should have some positive impact, we found that they were generally not sufficient to mitigate the risk from remuneration structures.

We identified a link between incentive schemes and conduct at point of sale. With one exception, those firms with the incentive schemes that had the most significant conflicts of interest were also the firms who engaged in pressure selling and other practices where a sale was prioritised ahead of the needs of the consumer. We do not consider that heavily sales-driven incentive schemes support a professional culture.

Some firms made changes to their frameworks in response to the LIF reforms which came into force on 1 January 2018. We expect that changes made by firms to comply with the reforms should reduce sales-driven behaviour and result in better consumer outcomes.

- In reviewing the targets, remuneration structures and performance management frameworks of the firms in our review, we focused primarily on frontline sales staff and the managers leading sales teams.
- We sought to understand whether these structures and frameworks encouraged behaviour that would lead to good consumer outcomes or created a conflict of interest by encouraging sales staff to put their own interests ahead of consumers'. We were particularly interested to understand the impact of variable performance benefits such as commissions or bonuses on the behaviour of staff.
- We also tested whether firms had policies and procedures in place that would reduce the risk of incentives driving poor behaviour, such as appropriately balanced scorecards, effective quality assurance frameworks and clawback arrangements.
- In this section, we use the term 'commission' to describe any variable remuneration based on the volume or value of sales made, including where the payment of such benefits is based on an assessment against a scorecard of measures.

## The link between incentives and poor sales conduct

- All firms had variable remuneration structures which rewarded sales staff for making sales. However, the extent to which the structures created a conflict of interest differed between firms. The more conflicted structures broadly correlated to a greater prevalence of poor conduct, particularly pressure selling, in the calls we listened to.
- We identified that five firms' variable remuneration structures created a conflict of interest and posed a higher risk of sales staff prioritising sales over good consumer outcomes. These firms all had very sales-driven incentive structures with multiple high-risk elements, including:
  - (a) minimum sales targets to unlock performance benefits such as commission or bonus schemes:
  - (b) a direct link between the value and/or number of policies sold and the amount paid; and
  - (c) uncapped commission.
- The four firms we identified as highest risk also had 'retrospective accelerators'—that is, incentive payments increased payments dramatically once certain targets were exceeded.
- In some of these firms, remuneration structures were designed so that commission formed a significant share of overall remuneration for sales staff—as much as 40% of their take-home pay. This will increase the impact of any sales-based targets on behaviour.
- We identified a link between the design of incentive schemes and conduct at point of sale. Four of the five firms with conflicted incentive schemes had instances of sales staff engaging in pressure selling (e.g. by objection handling inappropriately or using a deferred payment to close a sale).
- Those four firms also had significantly higher incidents of other behaviour that reduced consumers' ability to make informed decisions. The conduct of sales staff from one firm which had substantially high rates of up-selling and cross-selling appeared to be clearly motivated by the design of the sales incentive scheme.
- Those four firms all engaged in outbound sales to some degree. Conflicted incentives combined with consumers receiving outbound calls—who are less likely to be well informed and engaged—creates an unacceptable risk of poor consumer outcomes.
- We characterised three firms' variable remuneration structures as lower risk.

  Of those firms:
  - (a) one had no minimum sales targets, and paid a very low flat fee per sale; and

- (b) two firms did set minimum sales targets but operated a bonus system, where capped annual or twice-yearly payments were more indirectly linked to performance against a balanced scorecard and depended on overall firm/business unit profitability.
- These three firms generally performed better in calls, with no evidence of pressure selling. Instead, the calls were highly transactional or functional in nature. All three firms had entirely or predominantly ceased outbound sales.
- We describe the features of firms' variable remuneration structures in more detail below to describe why they create or reduce risk.
- However, we also found that there was not always a direct link between conflicted incentives and poor sales conduct. One of the four firms with the riskiest structures had no sales calls in our review demonstrating pressure selling. Conversely, the firm with the highest instance of pressure selling had some, but not all, of the risky features we describe below.
- We describe how other factors, including broader sales culture, may have contributed to these outcomes in Section H.

# Sales incentives and targets

All firms in our review offered some form of variable remuneration or performance benefit, for example bonuses or commissions, to sales staff and team leaders. The following features, in particular, can create a conflict of interest and drive sales-focused behaviour.

#### Minimum sales targets and gate openers

- Seven of the eight firms in our review had minimum targets based on sales or sales-related performance, such as the number or value of sales, and conversion rates. One firm also had a minimum target for cross-selling. Failure to meet these targets could result in performance coaching or more formal action.
- A 'gate opener' is a target that must be met before a staff member becomes eligible for commission or a bonus.
- Seven of the eight firms had a gate opener that included sales targets. This creates the risk of sales staff pushing a sale even when this is against the consumer's interests. This risk increases when the sales person is close to meeting the target. The bigger the potential jump in reward for exceeding the threshold, the bigger the conflict and the risk of poor conduct.

#### Case study 23: The financial impact of gate openers

One firm had a gate opener which required the sales person to make a certain number of sales per month. If they made between 0 and 15 sales, they would receive \$0 commission. If they made only a single additional sale, they would receive just under \$1,000.

In another firm, the impact of meeting the threshold was that commission increased from \$0 to almost \$9,000 per month as a result of a single sale above the monthly sales target.

- Three of the eight firms had gate openers based solely on sales, which creates a substantial risk of poor sales conduct.
- Four of the eight firms had gate openers based on meeting both sales and minimum quality assurance targets. While including quality assurance is welcome, it does not eliminate the risk of sales targets driving poor conduct.

#### Sales-based commission and bonus calculations

All eight firms calculated the amount of variable remuneration based on the volume or value of sales made, either in part or in full. This creates a conflict of interest and the risk that sales are prioritised over good consumer outcomes, as there is a direct link between sales and the amount of reward sales staff receive.

#### Volume-based commissions

- Three firms had volume-based commissions—that is, the commission was calculated based on the number of sales made, generally as part of a balanced scorecard. Sales staff received a flat fee per sale, provided they had met their required targets. In two of the firms the amount of commission per sale was so sizeable as to drive sales behaviour, whereas in one firm the amount paid was negligible and unlikely to impact behaviour.
- Volume-based commission creates the risk that sales staff are motivated to sell as many policies as possible, regardless of what the consumer wants.

  Specifically, it may encourage sales staff to:
  - (a) persuade consumers to buy multiple policies in a single call, either multiple types of cover or to multiple members of a single family;
  - (b) automatically bundle additional cover types to achieve multiple sales;
  - (c) pressure consumers to buy less comprehensive cover (e.g. accidental death insurance) after they are declined for the cover they originally sought; and
  - (d) reduce the sum insured to a level of cover much lower than the consumer requested, but that they can afford, to secure a sale.

- We saw examples of some of this conduct in sales calls, which appeared to be motivated by the incentive scheme—in particular, the practice of downgrading cover and repeatedly reducing the sum insured to close a sale.
- We welcome the fact that some firms have safeguards to reduce such risks.

  Examples included capping the number of policies in a single call that could earn commission or monitoring indicators of potentially poor sales (e.g. multiple calls with a short duration and low written premium values) and subjecting such calls to greater scrutiny.
- However, a more effective approach would be not to incentivise such behaviour in the first place.

#### Value-based commissions

- Four firms calculated commissions on the value of premiums for sales made. In addition to concerns noted earlier, this creates an additional risk that sales staff will encourage consumers to take out higher cover, and potentially more than they need or can afford. It is also likely to encourage sales staff to suggest a sum insured to the consumer, leading to poor consumer outcomes: see paragraphs 255–258.
- Two firms sought to reduce this risk by capping the premium amount that would be factored in for calculating commission.

#### Case study 24: Combining value and volume-based benefits

One firm combined both, basing the calculation of the core commission on the number of policies sold, and then applying a multiplier based on value. While this reduces the likelihood of sales staff selling a large number of low-value policies, it does significantly increase the risk of upselling, especially as the multiplier targets were high.

#### Case study 25: Value-based commissions and bundling

One firm operated an incentive scheme that calculated commission based on the value of the annualised first year's premium. This amount was not based just on the premium value of the 'core' policy but included the value of any additional benefits or riders sold. The firm was also the only one in the review to have a specific cross-selling target for sales staff.

We saw this reflected in their staff's behaviour. The firm was one of two seen to 'bundle' additional products in our review of sales calls. We also noted a high number of calls where the sales person ignored requests from consumers to be quoted on a lower sum insured. While the firm sought to mitigate the impact of its commission structure by placing a cap on overall premiums per sale for commission purposes, this was inadequate, and did not appear to prevent the poor conduct.

#### **Retrospective accelerators**

A 'retrospective accelerator' is a feature of a remuneration structure where sales staff receive higher rates of pay after certain sales thresholds are achieved, not just for subsequent sales but for all sales already made in that period. Such structures create significant conflicts of interest because a single additional sale can have a large impact on the amount of commission a sales person receives in that period.

Four out of the eight firms had a retrospective accelerator within their remuneration structure. None of these firms had a process for reviewing the individual call that makes the sales person eligible for this additional commission, even though the risk of inappropriate conduct is extremely high.

#### Case study 26: Financial impact of retrospective accelerators

One firm applied a retrospective accelerator for frontline sales staff where achieving at least 100% of the monthly sales target would result in a bonus equal to a set percentage of total sales and amount to around \$9,000. Achieving at least 105–110% of the sales target would result a much larger bonus equal to over \$15,000. A single additional sale, if it allowed a sales person to exceed the higher target, would therefore lead to an increase of around \$6,000 for the month. The firm did not target the sales that tipped staff into a higher commission amount for quality assurance.

## Other features increasing the risk of sales-driven conduct

- We identified other features that appear to exacerbate the risk of remuneration structures encouraging sales staff to engage in pressure selling or other poor conduct to close a sale and are likely contribute to poor consumer outcomes.
- These features included:
  - (a) a high percentage share of flexible to fixed pay;
  - (b) uncapped commission or bonuses;
  - (c) frequent and public monitoring of sales targets;
  - (d) additional reward for stretch targets based on sales;
  - (e) team targets that have to be met to qualify all team members for commission payments, irrespective of individual performance;
  - (f) frequent payment of performance benefits; and
  - (g) sales-driven performance benefits and targets for team leaders.
- The documents we reviewed for some firms stated how remuneration was split between fixed and variable pay. The ratio of fixed to variable was mostly between 90/10 and 75/25. We were particularly concerned that one firm had a target ratio of 60% fixed to 40% variable remuneration. This creates significant risk that sales staff will put their own interests ahead of those of the consumer.

- Six out of the eight firms did not cap the amount a sales person could receive in commission. This creates a greater incentive to push sales and is likely to foster an aggressive sales environment.
- In general, firms assessed sales staff against their targets continuously. Exact periods varied, but in some cases, targets were monitored on a daily basis. Short assessment periods and payment of bonuses or commissions on a fortnightly or monthly basis will likely contribute to a more sales-driven culture. This is because the link between performance against sales targets and the amount of commission or bonus a sales person can receive is direct and immediate, and therefore likely at the forefront of their mind.
- Some firms also ran dashboards or other live tracking tools, where sales staff could not only see how they were performing against sales and other targets, but also how much commissions they were due to earn. Some of these tools pitted their own performance against others in the team.
- A small number of firms had occasional stretch targets for teams based on meeting priority sales targets, which were rewarded with at times substantial additional payments if met.
- Four out of eight firms also had incentive schemes for team leaders with their team's sales performance a dominant factor. If a team leader's commission is dependent on sales targets, team leaders could put pressure on sales staff to achieve those targets, creating risks for consumers.

# Mitigating the risks of sales-focused incentives

#### **Balanced scorecards**

- Seven of the eight firms in the review had a combination of sales targets and non-sales related targets, combined in to a balanced scorecard to assess performance. The scorecards generally covered sales and other sales-related targets (such as conversion rates); productivity measures (such as log-in hours, dial time and punctuality); and quality assurance scores.
- Some firms also assessed performance against other measures such as:
  - (a) policies cancelled during the cooling-off period, downgraded or lapsed;
  - (b) adherence to sales techniques;
  - (c) cross-selling success rates;
  - (d) consumer complaints;
  - (e) consumer satisfaction/net promotor scores; and
  - (f) adherence to firm values.

- A genuinely balanced scorecard should allow firms to motivate sales staff while retaining an overall focus on doing the right thing by consumers.
- For the firms in our review, we consider that sales-related measures made up too much of a share for them to be considered truly balanced. In all seven scorecards, sales or sales-type targets formed more than one third of the scorecard, but it could be as much as 40–50%. This creates a greater emphasis on sales over consumer outcomes and can lead to a sales-driven culture.
- The firm not using a balanced scorecard had a very simple target structure, with the only target relating to minimum quality assurance scores rather than number of sales.

#### Quality assurance as a risk mitigator

- All firms used quality assurance assessments to mitigate the risk from conflicted incentives.
- Firms sought to do this in several ways, for example:
  - (a) five firms had gate openers based solely or in part on quality assurance, so sales staff were not eligible for commission unless they met minimum quality assurance targets;
  - (b) other firms reduced the commission paid to sales staff if they accumulated a certain number of breaches or their overall scores fell below certain thresholds;
  - (c) two firms had structures in place where no commission would be paid on any individual sale where a sales person had failed quality assurance; and
  - (d) other firms used quality assurance as a multiplier or additional reward—that is, a sales person's commission would be determined in part by how well they performed on quality assurance assessments, with good scores leading to an increase in commission received.
- We welcome these features and consider that effective quality assurance frameworks should reduce the risk from sales targets and sales-focused incentive schemes somewhat. However, on balance we do not consider that they are effective at removing or adequately managing conflicts of interest.
- More broadly, these measures were ineffective because of deficiencies in the quality assurance framework, or how it interacted with the variable remuneration scheme. For example, as discussed in the Section F:
  - (a) the framework often was not designed to detect all behaviour that would put the sales person's interest before that of the consumer;

- (b) the score to pass quality assurance was often low, and poor sales conduct might not result in an immediate fail;
- (c) quality assurance sampling was not always sufficiently risk-based; and
- (d) the size of quality assurance samples for assessment was often inadequate.
- Additionally, the impact of poor quality assurance assessments on commission was in some instances negligible. For example, in one firm, sales staff could receive an average assessment score of only 50–70% and still get 70% of the commission they were eligible for.
- We were also concerned that in two firms, sales that had failed quality assurance could still count towards total sales required to be eligible for any commission. This reduces the positive impact of any quality assurance process and reinforces the conflict and a sales-driven culture because the upside from making a sale (being eligible for commission and potentially achieving the accelerator target) is likely greater than the downside risk (not being paid commission for an individual sale that failed or receiving a lower percentage share of commission).
- In some instances, additional payments awarded for good sales conduct appeared somewhat insignificant when compared to total commission. One firm paid sales staff an additional \$200 for consistent high quality assurance scores over a month, but they could earn several thousand dollars in sales commission over the same period.

#### Clawback

- Clawback is an arrangement where all or part of a sales person's commission is recovered or forfeited if the policy is cancelled during the cooling-off period, or it is cancelled by the consumer or lapses within a set period.
- All but two firms had some system in place that sought to guard against staff being rewarded for sales that did not last. Some firms deducted any sales that resulted in lapses or cancellations from a sales person's total sales for the purposes of assessing performance and calculating commission, while others clawed amounts back.
- Six firms only measured cancellations during the cooling-off period. Only one firm assessed cancellations and lapses up to two months. Several firms also applied clawback if the consumer reduced the sum insured.
- While these clawback arrangements are welcome, they are not sufficient incentives for good sales conduct. A longer clawback period would be more effective, as it can take consumers longer than two months to act on a poor sale.

#### Performance reviews and sanctions

- All firms managed the ongoing and longer-term performance of sales staff using balanced scorecards. In several firms, annual or bi-annual performance reviews were used to measure staff against a slightly broader range of metrics than the day-to-day targets, including in some instances adherence to corporate values.
- In three firms, the regular (annual or six-monthly) performance review was significant as this assessment formed the basis on which eligibility for bonuses was calculated, as well as eligibility for pay increases.
- For all other firms, annual performance reviews did not have as much of an impact. While performance reviews determined eligibility for pay increases and in some instances promotion, we consider that the ongoing assessments against sales targets, and the fact that performance benefits were paid and calculated on a more frequent basis (i.e. fortnightly or monthly) carried more weight in driving behaviour.
- All firms also monitored performance against targets on an ongoing basis and had sanctions in place if staff were not meeting their performance targets. These ranged from informal (more coaching) to formal disciplinary action. Repeated failure to meet targets would result in dismissal.

  Performance management measures applied not only to quality assurance performance, but also to any staff who failed to meet their sales targets.
- Additional training and sanctions may encourage improved conduct where they involve quality assurance and other consumer-focused metrics. However, if incentive schemes remain conflicted and continue to promote sales-driven conduct, these actions are unlikely to mitigate all poor sales conduct.
- We saw evidence of poor performance management in one firm where several sales staff recorded very poor quality assurance scores over several months, but they appeared to be allowed to remain on the phone and sell policies.

# Implications of the Life Insurance Framework (LIF) reforms

- The LIF reforms, which came into effect on 1 January 2018, reduce conflicted remuneration for sales of life insurance.
- The reforms:
  - removed the previous exclusion from the ban on conflicted remuneration for benefits paid in relation to advice on life insurance products;
  - (b) inserted a new exclusion for benefits paid if they are level commissions or certain commission caps and clawback arrangements are met; and

(c) provide that the ban on conflicted remuneration will also apply to certain benefits in relation to information given on, or dealing in, a life insurance product.

Note: The previous and new exclusion does not apply to monetary benefits relating to the following products: a group life risk policy inside superannuation, whether it is for a default superannuation fund or another type of superannuation fund; and an individual life insurance policy for the benefit of a member of a default superannuation fund.

- The reforms mean that some remuneration arrangements in direct life insurance markets need to change. In the context of the direct sale of life insurance products, to comply with the LIF reforms, firms who pay any form of conflicted remuneration to their sales staff or appointed representatives under a general or no advice model must change the remuneration structure to remove such conflicts.
- Alternatively, firms may seek to benefit from one of the exemptions under the LIF reforms—for example, that the benefits paid satisfy the 'benefit ratio' (i.e. they fall below the commission caps set by the legislation) and that they have the necessary clawback arrangements in place, or alternatively they may pay a level commission for the life of the policy.

Note: The commission cap in first year (i.e. upfront commission) is 80% for products issued in 2018, 70% for products issued in 2019, and 60% for products issued from 1 January 2020. The commission cap after the first year (i.e. trailing commission) is 20% from 1 January 2018. See Regulatory Guide 246 Conflicted and other banned remuneration at RG 246.277 and RG 246.278 (for clawback arrangements). See also \$963B(1)(b), regs 7.7A.11C(1)(d) and 7.7A.11D(1)(b), and paragraphs 5(2) and (3) and 7 of ASIC Corporations (Life Insurance Commissions) Instrument 2017/510.

- As noted earlier, a number of firms in our review had remuneration structures that were conflicted remuneration. Firms have responded to the LIF reforms in various ways—some redesigned their schemes or took steps to comply with the commission caps and clawback arrangements, while others made no changes.
- We are still assessing firms' responses to the reforms. However, we expect that the LIF reforms will reduce poor sales conduct where firms redesign their schemes to remove conflicted remuneration or comply with the cap and clawback. We consider that the requirement to introduce clawback over a two-year period should change behaviour at point of sale and have a material impact on the unacceptably high cancellations during the cooling-off period and subsequent lapses that we observed in direct life insurance.
- The LIF reforms also apply to remuneration arrangements between firms, and this is highly relevant in the direct life insurance market given that many distributors are not insurers themselves but sell products issued and underwritten by insurers with whom they have entered into an agreement. We expect that the LIF reforms will impact these arrangements too. For example, firms are likely to move towards paying distributors a level commission for the life of any given policy, rather than a combination of higher upfront commission and lower trail commission.

Again, we expect that the focus of remuneration arrangements on rewarding longevity should contribute to lower lapses and better overall consumer outcomes. However, the payment structures between entities in the direct life insurance value chain are complex, and further work may be necessary for us to be satisfied that firms are complying with the LIF reforms, and that these changes will have the desired effect of driving better consumer outcomes.

#### ASIC action 5: Reviewing the impact of LIF reforms

- We will continue to assess how firms have responded to the LIF reforms. In particular, we will assess whether firms have implemented strict clawback provisions to complement the commission cap where necessary.
- We expect that the introduction of the LIF reforms should lead to lower lapse rates, and we will monitor these outcomes on an ongoing basis: see ASIC action 1.
- As part of our 2021 review to test whether the LIF reforms have achieved their objective of improving the quality of advice, we will also assess whether a reduction in conflicted remuneration has led to better consumer outcomes in direct sales of life insurance.

# **H** Culture

#### **Key points**

We used a review of sales culture to help us understand what conduct we were seeing and why it was occurring. We did this by:

- asking firms for their 'target culture' (i.e. to describe their values and desired consumer outcomes and how these were embedded and measured); and
- comparing this to the 'observed sales culture' from our assessment of processes, practices and behaviour of sales staff in sales calls.

While we found some examples of consumer-focused culture delivering good outcomes in practice, this was often not the case. We also saw numerous examples of cultural disconnect or inconsistencies, such as:

- situations where what happened in practice in the calls differed markedly from what the firm set out to do;
- tension between different business practices, which meant that the firm could not consistently deliver good consumer outcomes; and
- differences between explicit messages (e.g. in training materials) and implicit messages in other material (e.g. compliance tests).

ASIC's role is not to prescribe what a firm's culture should look like. Rather, we have focused on describing what we observed, and how any disconnects or inconsistencies may be leading to poor conduct and poor outcomes.

We recommend that firms consider the examples of cultural disconnects or misalignments we describe and how they may apply to their business.

- A firm's culture ultimately shapes or helps determine consumer outcomes.

  To help us understand what might be driving poor consumer outcomes in the direct life insurance market, we considered culture as part of our review.

  This was a useful 'lens' to help us understand what we were seeing and why, and formed an important part of our feedback to the firms we reviewed.
- Culture remains a key priority for ASIC. This review of culture was a pilot project for ASIC to help us further refine our approach to understanding culture.
- Corporate culture is complex and multi-dimensional: it influences the behaviour of staff, but is also a product of this behaviour, and of other factors such as corporate values, leadership, processes, and business practices.
- We focused on the sales culture of a selection of the firms in our review as it related to the sale of direct life insurance.

# Our approach to assessing culture

- We treated culture as an output—that is, something that is influenced by a range of inputs—values, processes and procedures on the one hand, and mindsets, beliefs, implicit values and the behaviour of staff on the other.
- Because culture can be difficult to measure or put in concrete terms, and mindsets and beliefs difficult to assess within the scope of a sales review, we used a staged approach. This helped us describe what we saw and point to concrete areas for improvement.
- First, we asked the firms in our review to describe their values, objectives and desired consumer outcomes. We asked them to tell us how they embed these in processes and practices, and how they measure adherence to them. Their responses gave us a sense of their 'target culture'.
- We then compared this to the findings from our review. We looked at how values were translated in to consumer outcomes, and whether they were linked to expected observable behaviours. We also assessed how these guiding principles were embedded into processes and practices such as scripts, training, incentives schemes and quality assurance frameworks, and whether this was done consistently.
- Through our extensive call listening exercise and review of quality assurance checks we also reviewed how this translated into actual practices and behaviour 'on the ground'. Taken together, all of this gave us a sense 'observed sales culture'.
- We then compared target culture and observed culture, to understand whether the two were aligned and genuinely consumer-centric, or whether there were any disconnects or inconsistencies.
- We applied this methodology to a subset of the firms in our review. We found some examples of consumer-focused culture delivering good outcomes, but also other examples where this was not the case.
- ASIC's role is not to prescribe what a firm's culture should look like. Rather, we have focused on describing what we observed, and how any disconnects or inconsistencies may be leading to poor conduct and poor outcomes.
- We recommend that firms consider the examples of cultural disconnects or misalignments we describe and how they may apply to their business. While our observations relate to the specific conduct and culture of a sample of the firms in our review, they have wider relevance to other firms in the sector.

## Firms' target culture

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All the firms we reviewed had one or more corporate values or objectives that focused on consumers.

However, when it came to translating these values and objectives into concrete consumer outcomes that could be measured and achieved, some firms could not articulate very clearly what 'good' looked like. In fact, some responded by telling us how the delivery of their objective was embedded in processes and was measured, without having articulated in more concrete terms what they thought a good outcome for consumers would be.

Some firms only focused on the point of sale and other customer service interactions when considering consumer outcomes. For example, they framed good consumer outcomes in terms of customer satisfaction and linked this to factors such as speed of service or politeness. Many firms measured outcomes through post-sale surveys, net promoter score (a customer loyalty metric) ratings, customer reviews, and customer service metrics.

Such measures are unlikely to fully capture consumer outcomes. A good outcome from a sale would be a consumer buying a policy they understand and can afford, that meets their needs, and that performs as they expected. Our consumer research highlighted consumers' poor understanding of life insurance at the time of purchase. Consumers or their families are also unlikely to make a claim for a significant time after the initial purchase. Given these factors, focusing on customer service metrics and reviews alone is not likely to give a complete or accurate picture of consumers outcomes.

Some firms stated that a good consumer outcome was consumers understanding their cover, or staff identifying and meeting a consumer need. While we welcome this description, we note that firms could not always articulate what this meant in practice or how they measured this outcome. Firms that did this well translated it into observable behaviours that they expected their sales staff to display during calls to help consumers understand and linked this to indicators of poor understanding and claims outcomes.

Firms that were less successful at specifying or measuring what this objective meant in practice appeared to see it more as an opportunity to sell. For example, sales staff were taught to ask consumers questions so that they could match product features against the answers and establish a need in the consumer's mind. But in the context of establishing and meeting needs, 'not selling' was not an option.

We were surprised and disappointed to see that firms did not focus more on claim outcomes and lapses when describing and measuring good outcomes. We saw little or no discussion of using declined or withdrawn claims as an indicator of whether consumers had understood what they were buying. Only one firm had set an explicit low target for lapse rates and expressed this in consumer-focused terms, noting that high lapse rates were likely to mean poor consumer outcomes.

While we asked for material that focused on the *sale* of direct life insurance, we nevertheless expected that firms would make a link between conduct at point of sale and actual consumer outcomes that reflect the purpose of life insurance (i.e. consumers successfully protecting themselves or their families in a difficult period).

Many firms had a value that focused on delivering results. This is not surprising. However, in some cases, this value translated rather narrowly into financial results or performance and appeared to dominate other values and objectives (e.g. particularly in how it was reflected in strategy and in targets and incentive schemes). While tension between different objectives is inevitable, we expect firms to be aware of these tensions, and to identify and manage them with a particular focus on customer outcomes.

The consumer's perspective was not always embedded in processes and procedures in a consistent way. While some firm's processes demonstrated a clear consideration of consumers' needs, in other cases we found that the design of internal policies (e.g. training, scripts or incentive schemes) appeared to contradict the overarching objective of 'doing the right thing by consumers'.

Some examples we discuss in Sections C–G of this report include:

- (a) scripts and training that emphasised techniques that heighten the risk of poor outcomes (e.g. objection handling and cross-selling);
- (b) training and/or design of quality assurance frameworks that focused on minimising risks to business rather than placing equal emphasis on the risk of poor consumer outcomes;
- (c) sales-driven incentive schemes; and
- (d) adherence to corporate values assessed only as part of annual appraisals rather than forming part of the eligibility for short-term incentives.

Overall, we found that all firms could do more to actively consider consumer outcomes and embed this value consistently in all their processes and procedures: see Sections C–G for our expectations in these areas.

### Comparing target culture with observed culture

- Although we saw some examples of good practice and clear cultural alignment, which we consider will lead to better consumer outcomes, we found more instances of cultural disconnect or inconsistencies. Examples included:
  - (a) situations where what happened in practice in the calls differed markedly from what the firm set out to do;
  - (b) tension between different business practices, which meant that the firm could not consistently deliver good consumer outcomes; and
  - (c) differences between explicit messages (e.g. in training materials) and implicit messages in other material (e.g. compliance tests).

## Case study 27: Disconnect between target culture and what happens in practice

One firm had a corporate goal that included the customer as one of three core elements. On paper, the firm stood out in terms of setting clear expectations of sales staff and policing behaviour diligently.

For example, the firm had a manual that described in very clear terms what an inappropriate sale looked like, and why it was not acceptable. It gave detailed descriptions of conduct that would be deemed an inappropriate sale and went further than others in recognising that implicit sales tactics might also be perceived as pressure by the consumer. The manual prohibited many of the behaviours that we have identified in this report as pressure selling or otherwise undermining decision making, including:

- advising the consumer of the need to set up the policy and/or collect payment details to send out the quote or policy documents; and
- selling in a manner where the customer is not committed to the product and only buys because of the opportunity to think about it.

This manual was attached to the quality assurance process. The firm also had a practice of assessing a large percentage of their sales calls: between 40% and 90% of all calls, depending on the product. These processes were well aligned with the intent to deliver good consumer outcomes and value.

However, we observed several instances where actual conduct did not align with the desired practices. Sales staff were very persistent in sales calls and some tactics amounted to pressure selling. In some calls, we observed conduct that was a clear breach of the firm's guidance about inappropriate sales. We reviewed quality assurance assessments conducted by the firm for two of these calls. Both were scored 100% and neither assessment identified, let alone penalised this poor conduct.

We are concerned about a clear disconnect in this firm between its policies and procedures and what actually happened in the calls, and the failure to identify this behaviour.

In our view, one cause of this disconnect was the firm's sales-driven incentive scheme. This firm had a number of features which we consider create a risk of sales staff putting sales before consumer needs, including minimum sales targets to make sales staff eligible for commission, commission calculated on both value and volume of sales, and a retrospective commission accelerator. Some language we heard in the calls aligned with our concern that sales staff were motivated primarily by making sales. For example, in one recording a sales person put a consumer on hold and asked their supervisor for permission to offer a discount, stating that they wanted to 'stitch the customer up' and hopefully cross-sell to the partner later that day.

We are also concerned that, where the quality assurance framework did identify issues, these were not promptly followed up. Some of the firm's sales staff had scored below the prescribed monthly average for quality assurance for several months. It appeared that while some staff eventually left the firm, they continued to be employed and make sales calls for some time, despite falling below expectations.

# Case study 28: Tension between different business practices and lack of clear expectations

While one firm's processes and procedures prohibited pressure selling and use of the cooling-off period to close a sale, we saw evidence of poor conduct in the calls we listened to. We identified widespread pressure selling and the use of other inappropriate sales techniques, including extensive use of deferred payments to close a sale (which appeared to be used as an alternative to the cooling-off period to persuade consumers to buy).

The firm's quality assurance framework had some weaknesses, but it was fairly comprehensive and tested for pressure selling. We also saw evidence of staff being given warnings and/or being dismissed for poor conduct.

However, based on our observations, we consider that other drivers were more dominant, and taken together created a sales-driven culture that the quality assurance process was not able to counteract:

- Failure to set clear expectations—Sales training was very focused on overcoming consumer objections and encouraged practices such as product bundling and upselling. The guidance on the limits of acceptable objection handling was complex and unclear and allowed sales staff to handle objections far too many times before ending a call. Pressure selling was only described in general terms; there was no clear line between good and poor conduct. This had a flow-on effect: while the quality assurance process tested for pressure selling, the firm acknowledged that sales team leaders and quality assurance staff sometimes argued about what was and was not permissible. We saw this reflected in the actual assessments we reviewed; we identified nine calls where there had been some pressure selling, but the firm only identified this conduct in one of those cases.
- Role modelling—The conduct we heard in sales calls was in fact fairly
  consistent between sales staff. This suggests that in the absence of
  explicit rules, implicit standards had developed, with staff 'setting their
  own standards' based on the behaviour of successful sales staff and
  role modelling from senior staff and team leaders.
- Incentives—Although the firm had an incentive scheme that encouraged sales-driven conduct, it was not the riskiest of the schemes we reviewed, lacking some riskier features, such as a retrospective commission accelerator. However, the relative simplicity of its 'straight through' commission model, where each sale was rewarded with a set dollar amount of commission, encouraged a very linear focus for sales staff on making as many sales as possible. The sales-driven environment was reinforced by the daily monitoring of targets, the use of dashboards where staff could track their performance against targets on a constant basis, and team names such as 'The Dragons', 'The Vipers' and 'The Elite' which pitted teams against each other.
- Recruitment—We consider that the way the firm recruited staff was likely
  to contribute to this cultural disconnect. While not formally part of this
  review, we considered current recruitment campaigns for this firm.
  Advertisements for sales staff sought 'money and target driven' individuals
  with 'a passion for sales and a hunger to succeed', emphasising fun and
  the availability of perks such as weekly and monthly prizes and uncapped
  commissions, without mentioning consumer outcomes.

#### Case study 29: Differences between explicit and implicit messages

In one firm, we identified differences between the general intent of policies and procedures and the more detailed and at times contradictory messaging to sales staff. The working-level messaging did not always align clearly with the stated objective of putting the customer first.

The firm's training was comprehensive and generally good quality, particularly in relation to products. Sales staff had a lengthy induction, and this was followed by a six-month period during which they had to map progress in a log book that charted their progress and tracked learning.

The compliance training referred to consumer expectations of fairness and noted that financial literacy is often low. It discussed pressure selling and when not to sell to consumers. While some of this information lacked detail, overall it was positive. However, other training material failed to highlight the consumer perspective and appeared to focus on minimising risk to business:

- Duty of disclosure—When discussing the importance of the duty of disclosure, the training manual read: 'Customers have a duty to disclose all relevant matters, if they fail, we may be able to decline their claim or avoid their policy from inception', and 'We have a duty to inform customers of their obligation, if we fail, [insurer] won't be able to take the remedies (decline claim or avoid contract), [insurer] might have to pay a claim it otherwise would not have paid...' While legally correct, this sends the wrong message to staff by not acknowledging the very serious implications for consumers in failing to disclose something, namely that they may buy cover they cannot claim on.
- Breaches—The section discussing the consequences of breaches
  focused only on the impact on the business, including reputational and
  financial loss, and the employee. The consumer was not mentioned.
- Compliance tests—Many questions in compliance tests for new staff were not framed in terms of the consumer but emphasised the need to minimise risk to business. For example, one question was: 'What is the risk to the business if we do not obtain a clear commitment to set up a policy? (i.e. if the customer is under the impression they are only receiving paperwork and not setting up a policy)'. The answers were: a) 'We can receive a fine, customer complaints, or even have to pay out a claim' or b) 'There is no risk to the business as the customer has agreed to receive the paperwork, so they will understand that they are covered'. There was no acknowledgement that the consumer might be buying a policy they did not want or understand.

The quality assurance framework was comprehensive, and sampling appeared robust with detailed requirements about appropriate sales conduct, including prohibiting certain behaviours that our review identified as unacceptable. Adherence to these behaviours was tested and a failure to meet the requirements amounted to an immediate fail.

However, there was a further disconnect in the messaging sales staff received. In the 'new joiner' log book, staff were advised to take on quality assurance feedback because 'not only do we want to protect the business, but we want you to earn some commissions' with was no reference to consumer outcomes.

We also noted that while a sales person would not receive a commission for any call that failed quality assurance, such calls still counted towards sales targets that made sales staff eligible for commission and hitting the next highest commission rate (as part of the retrospective accelerator). This weakens the punitive impact on the sales person's take home pay of having performed poorly in assessments.

#### Case study 30: Consumer-centric design and distribution

Our review of one firm highlighted the strong positive impact that a consumer-centric business model can have and how this can mitigate the risk created by other business practices.

The firm had a stated goal of putting the customer first and had various corporate values that were intended to guide the organisation in how to deliver this. In setting out the firm's philosophy, there was a reference to putting customer needs before profits. The firm had also clearly articulated what a good consumer outcome would look like, focusing both on the sales journey, including an emphasis on consumer understanding, and on giving consumers certainty at claim time. Product offerings and distribution strategy appeared to be designed to ensure they could meet these goals, by offering comprehensively underwritten products aimed at a clearly articulated target market, distributed through inbound sales calls only.

This firm had also set a maximum target for lapse rates (effectively a cap) and made it clear that high lapse rates were deemed a bad outcome, not only for the firm but also the consumer.

This firm performed well in the calls we listened to. Sales staff took their time to engage with consumers, gave detailed explanations of the cover and the necessary process, and answered questions well. We did not observe any examples of pressure selling, downgrading cover or other problematic practices such as bundling or framing choices by setting products or sums insured. Additional products were offered but they were explained clearly and not pushed if the consumer was not interested.

In addition, this firm's lapse rates were significantly below the average of all other firms in our review.

When we reviewed this firm's processes and procedures, we were surprised to find several things that appeared at odds with the high-level goals and good conduct and outcomes, including:

- sales staff were trained in objection handling, and the quality assurance framework not only tested that sales staff had done enough to close a sale but also awarded more points to objection handling than some consumerfocused elements of a call (e.g. explaining benefits of cover well); and
- the firm had stated targets of securing bank details in a set percentage of calls.

In addition, we noted that the firm's incentive scheme ranked as one of the riskiest of all the firms in our review, including minimum sales targets to become eligible for and increase commission (although the risk from this scheme may have been reduced somewhat by offering sales staff a relatively high base salary, and recruiting on a permanent basis).

Our analysis suggests that there was some disconnect between stated objectives and the design of business practises.

We consider that the way high-level values were translated in to specific and measurable consumer outcomes and into decisions about product design and distribution allowed the firm to mitigate the risks created by this disconnect. However, if the firm were to significantly change its product suite or distribution approach, this would likely result in worse consumer outcomes unless some of these misalignments in policies and procedures are addressed.

### **Appendix 1: Methodology**

The following firms were included in our review:

- (a) Six insurers that sold directly to consumers—These firms were ClearView Life Assurance Limited, NobleOak Life Limited, OnePath Life Limited, Suncorp Life & Superannuation Limited, TAL Life Ltd, and The Colonial Mutual Life Assurance Society Limited.
- (b) Three distributors selling on behalf of two insurers—These firms were Auto & General Services Pty Ltd and Greenstone Financial Services Pty Ltd selling on behalf of Hannover Life Re of Australasia Ltd, and Select AFSL Pty Ltd selling on behalf of St Andrew's Life Insurance Pty Ltd.

### **Data collection**

- At the start of our review in 2017, we collected the following information from the eight insurers in our review:
  - (a) Sales and claims data—This included the number of lives insured for in-force policies at the start and end of each year from 2014–16 and the number of lives insured of new policies written each year. This was split by inbound or outbound distribution channel and underwriting type (full, limited or no underwriting at the point of sale).
  - (b) Claims data—This included the number of claims reported, admitted, declined and withdrawn as well as 'other' outcomes in the year and the number of claims outstanding at the end of each year from 2014–16. This was split by inbound or outbound distribution channel and underwriting type (full, limited or no underwriting at the point of sale).
  - (c) Lapse information—We asked for the proportion of lapsed policies—including consumer cancellations and lapses due to non-payment of premiums—for each insurer's individual direct life insurance products where the entire policy was cancelled (i.e. excluding where cover was reduced or where one cover type under a broader policy was cancelled).

Note: Where an insurer had multiple distributors, we collected data for all their distributors who sold 'direct'.

The lapse data was provided separately for each year of policy inception from 2012–16 and included the percentage of policies that lapsed:

- (a) in the cooling-off period,
- (b) within six months,
- (c) between six and 12 months,
- (d) between 12 and 24 months, and
- (e) between 24 and 36 months.

- For the purposes of our data collection, we primarily distinguished between full and limited underwriting from the outcome of the process:
  - (a) Limited underwriting involves assessing the consumer's risk based on limited medical questions, with the result being that the consumer is declined or accepted for the cover on standard terms.
  - (b) *Full underwriting* generally includes more comprehensive questioning and may result in the application of an individual medical exclusion or premium loading to the consumer's policy but may also result in the consumer being declined cover.
- Financial advisers will sometimes provide general advice when selling life insurance, which may be considered a direct method as no personal advice has been given. However, this distribution method was excluded from our data collection as firms advised us that these sales are generally not recorded in a way that is easily extracted from all other sales by financial advisers.
- We also sought updated data from firms in mid-2018. Rather than issue an additional data request, we mostly relied on data collected through other regulatory processes:
  - (a) The ASIC-APRA claims data collection—We obtained consent from the firms in our review to use aggregate claims information for each cover type for the first six months of 2017, which they had provided for the claims data collection. We also sought this information from the friendly society in our review that was not captured by this data collection.
  - (b) LIF reform data collection—We relied on data collected by ASIC as part of an ongoing data collection to test the effectiveness of the LIF reforms. This included cooling-off cancellations and lapses within six months of policy inception for policies sold in the first half of 2017, and cooling-off cancellations for policies sold in the second half of 2017, for each cover type.
- There were some minor differences in these data collections compared to the initial data we had collected. We therefore only used this data where it could be determined that any differences were likely to be immaterial.
- Given our concerns about the sale of accidental death insurance and the limitations of the cover, we also sought data from each of the insurers to assess the claims ratio of this product, including the gross earned premiums and the gross incurred claims for the financial years 2015–17.

### Sales call review

- In our *first call review*, we obtained 151 sales calls from 2010–16 where the policy had lapsed within three years or there had been a declined claim, to assess whether the sales call may have contributed to this outcome.
- We asked for sales calls from eight firms for three product types: term life, income protection and accidental death insurance. We selected these products as they are more commonly sold as standalone cover in the direct life industry, compared to trauma and TPD insurance. By asking for these product types, we also captured sales of trauma and TPD cover as 'riders' to the main benefit.
- For each product type, we asked for:
  - (a) the four most recently lapsed policies, where the lapse had occurred within three years of policy inception; and
  - (b) the four most recently declined claims, where the original policy was sold in the seven years before the claim was declined.
- As a result, the sales calls we obtained were mostly from 2010–16, with a small number of sales in January–March 2017. We also asked for the PDS, the policy schedule, supporting documentation and correspondence relating to the lapse or declined claim.
- We listened to each sales call and recorded our observational assessments about the quality of information given and the sales conduct engaged in during the call. We reviewed correspondence and supporting documentation about the claim or lapse to assess whether there was an observed link between the sales call and the subsequent outcome.
- In some cases, the link was overt (e.g. where a consumer was pressured to buy the policy by providing payment details to receive policy documents, and subsequently called to cancel as they had not intended to buy it). In other cases, we identified links due to sales conduct or an absence of information and subsequent consumer behaviour (e.g. premium increases were not discussed, and the policy subsequently lapsed shortly before or after the first premium increase, due to a failed or cancelled direct debit payment).
- For declined claims, we identified a link where it appeared that the consumer would have reasonably expected the policy to cover them for their subsequent claim based on the sales call. Examples included where a key exclusion was not mentioned or adequately described, or the consumer was downgraded to a more limited product than they initially applied for.
- In the *second call review*, we obtained 393 sales calls from eight firms. This larger review contained sales calls from July and August 2017 (after the introduction of the Code); its purpose was to assess whether more recent sales conduct had improved or if problematic conduct was still occurring.

- We asked for a random selection of sales calls, along with a targeted selection of calls to ensure adequate coverage of different products types and policies with particularly high sales or risky features.
- Calls targeting specific products were selected using 2016 sales data, taking into account:
  - (a) the product type (i.e. term life, income protection, accidental death, trauma and TPD);
  - (b) the level of sales activity of the product;
  - (c) products with pre-existing condition exclusions; and
  - (d) underwriting type.
- We listened to each of the sales calls and recorded our observational assessments about the quality and manner of information given to the consumer during the call. We also reviewed the PDS and policy schedule.
- We asked for policies and procedures as at August 2017 (the period of our call review) for training and scripts, quality assurance, targets, incentives and performance management. We assessed these documents to see if there were links to the behaviour we observed in our sales call review.

### **Appendix 2: Accessible versions of figures**

This appendix is for people with visual or other impairments. It provides the underlying information for the figures presented in this report.

Table 3: Lives insured at start of year, direct life insurance, 2014–17

Product	2014	2015	2016	2017
Term life	245,312	259,217	275,276	289,716
Accidental death	202,558	188,260	178,823	167,920
Income protection	64,305	73,658	80,074	80,539
Trauma	37,034	40,881	48,001	56,728
TPD	13,225	17,542	18,604	19,349

Note: This is the data contained in Figure 1.

Table 4: Lives insured for new sales, 2014-16

Firms	2014	2015	2016
Firm A	36,094	44,420	61,498
Firm B	41,643	38,921	33,409
Firm C	30,494	30,554	12,844
Firm D	17,558	18,031	13,628
Firm E	28,686	1,346	1,025
Firm F	10,253	10,669	4,562
Firm G	556	9,223	13,732
Firm H	1,914	3,167	5,139

Note: This is the data contained in Figure 2: Lives insured for new sales, 2014–16.

Table 5: Lives insured for new sales—outbound sales, 2014–16

Firms	2014	2015	2016
Firm A	10,253	10,669	4,562
Firm B	28,686	15	12
Firm C	11,617	19,583	45,992
Firm D	61	715	1,212
Firm E	19,225	21,878	8,151
Firm F	556	9,223	13,732
Firm G	4,827	3,441	1,151
Firm H	12,271	9,861	6,559

Note: This is the data contained in Figure 3.

Table 6: Proportion of new sales—Underwritten versus guaranteed acceptance, 2014–16

Underwriting type	2014	2015	2016
Underwritten	69%	74%	73%
Guaranteed acceptance	31%	26%	27%

Note: This is the data contained in Figure 4.

Table 7: Claims admitted, declined and withdrawn, by product type, 2014–17

Product type	Admitted	Declined	Withdrawn
Term life	75%	14%	11%
Trauma	68%	15%	17%
Income protection	54%	14%	32%
TPD	44%	26%	30%
Accidental death	26%	36%	38%

Note: This is the data contained in Figure 5.

Table 8: Proportion of policies cancelled during the cooling-off period, by firm, 2014–17

Firm	Cooling-off rate
Firm A	31%
Firm B	25%
Firm C	23%
Firm D	16%
Firm E	16%
Firm F	13%
Firm G	8%
Firm H	3%

Note: This is the data contained in Figure 6.

Table 9: Proportion of policies lapsed within three years, by firm, 2012–17

Firm	0–6 months	6–12 months	12–24 months	24–36 months
Firm A	26%	12%	12%	8%
Firm B	16%	13%	15%	9%
Firm C	17%	11%	12%	8%
Firm D	15%	11%	14%	8%
Firm E	20%	8%	10%	9%
Firm F	21%	8%	9%	5%
Firm G	14%	8%	10%	7%
Firm H	5%	1%	3%	4%

Note: This is the data contained in Figure 7.

Table 10: Consumer research, exclusions and limits of policy

Consumer survey response	0-6 months
I assume exclusions exist but don't know what they are	34%
I am not aware of any exclusions	25%
I don't know	7%
I know the exclusions because the sales person told me	24%
I know the exclusions because I read the PDS	10%

Note: This is the data contained in Figure 8.

Table 11: Claims outcomes for income protection, guaranteed acceptance versus underwritten

Underwriting type	Admitted	Declined	Withdrawn
Guaranteed acceptance products	58%	16%	26%
Underwritten products	50%	13%	37%

Note: This is the data contained in Figure 9.

Table 12: Claims outcomes for term life, guaranteed acceptance versus underwritten

Underwriting type	Admitted	Declined	Withdrawn
Guaranteed acceptance products	68%	16%	16%
Underwritten products	75%	15%	11%

Note: This is the data contained in Figure 10.

Table 13: Claim outcomes for accidental death, by firm

Firms	Admitted	Declined	Withdrawn
Firm A	13%	43%	44%
Firm B	52%	33%	14%
Firm C	51%	14%	36%
Firm D	20%	37%	43%
Firm E	30%	30%	40%

Note: This is the data contained in Figure 11.

Table 14: Proportion of sales calls assessed for quality, July 2017

Firms	All cover	Cover 1	Cover 2	Cover 3
Firm A	25%	_	_	_
Firm B	15%	_	_	_
Firm C	9%	_	_	_
Firm D	20%	_	_	_
Firm E	_	23%	11%	34%
Firm F	_	89%	85%	45%
Firm G	_	10%	7%	4%

Note: This is the data contained in Figure 13.

# **Key terms**

Term	Meaning in this document
2015–17 financial years (for example)	The financial years (1 July to 30 June) ending in a given year (in this example, the three years ending 30 June 2015, 2016 and 2017)
accidental death insurance	A life insurance policy that pays a lump sum benefit if the policyholder dies as the result of an accident only
AFS licence	An Australian financial services licence under s913B of the Corporations Act that authorises a person who carries on a financial services business to provide financial services
	Note: This is a definition contained in s761A.
AFS licensee	A person who holds an AFS licence under s913B of the Corporations Act
	Note: This is a definition contained in s761A.
APRA	Australian Prudential Regulation Authority
APRA-ASIC claims data collection	Data on life insurance claims and claims related disputes for the period 1 January 2017 to 30 June 2017 published by APRA and ASIC: see <a href="18-150MR">18-150MR</a>
ASIC Act	Australian Securities and Investments Commission Act 2001
claims ratio	The value of claims paid by an insurer as a proportion of premiums received, calculated by dividing gross earned premiums by gross incurred claims
commission	Any payment under a variable remuneration structure, n based on the volume or value of sales made, even where the payment of such benefits is based on an assessment against a scorecard of measures
conflicted remuneration	A benefit given to an AFS licensee, or a representative of an AFS licensee, who provides financial product advice to clients that, because of the nature of the benefit or the circumstances in which it is given:
	<ul> <li>could reasonably be expected to influence the choice of financial product recommended by the licensee or representative to clients; or</li> </ul>
	<ul> <li>could reasonably be expected to influence the financial product advice given to clients by the licensee or representative</li> </ul>
	In addition, the benefit must not be excluded from being conflicted remuneration by the Corporations Act or Corporations Regulations 2001
consumer research	Quantitative and qualitative research conducted by Susan Bell Research for ASIC with consumers who had recently bought direct life insurance: see REP 588

Term	Meaning in this document
Corporations Act	Corporations Act 2001, including regulations made for the purposes of that Act
Code	The Life Insurance Code of Practice developed by the FSC
direct life insurance	Life insurance that is sold to consumers directly, without an adviser providing personal or general advice, and without a group intermediary like a superannuation fund
financial adviser	An advice provider
financial service	Has the meaning given in Div 4 of Pt 7.1 of the Corporations Act
FSC	Financial Services Council
FSI	Financial System Inquiry
gate opener	A target that must be met before a staff member becomes eligible for commission or a bonus. They can be based on sales or on quality measures, such as quality assurance scores
general advice or general financial product advice	Financial product advice that is not personal advice  Note: This is a definition contained in s766B(4) of the  Corporations Act.
group insurance	Life insurance policies issued to a third party (e.g. a superannuation trustee) that policyholders can access through their membership of the fund
income protection cover	A life insurance policy that replaces the income lost if the policyholder is unable to work for a certain amount of time due to injury and or sickness
insurer	The company that issues the life insurance policy
LIF reforms	The Life Insurance Framework reforms, which came into effect on 1 January 2018
life insurance	An insurance policy that pays either a lump sum or income stream payment in the event of death, illness, disability. Life insurance policies can include cover for death, total and permanent disablement, trauma and income protection
Life Insurance Act	Life Insurance Act 1995
life insurance policy	A life insurance contract as defined in s9 of the Life Insurance Act, excluding investment or annuity-related contracts
personal advice	Financial product advice given or directed to a person (including by electronic means) in circumstances where:
	<ul> <li>the person giving the advice has considered one or more of the client's objectives, financial situation and needs; or</li> </ul>
	a reasonable person might expect the person giving the advice to have considered one or more of these matters
	Note: This is a definition contained in s766B(3) of the Corporations Act.

Term	Meaning in this document
PJC	Parliamentary Joint Committee on Financial Services
PJC report	A report issued by the PJC, <i>Life insurance industry</i> (March 2018)
policyholder	The person who holds the life insurance policy (also known as the 'insured') or superannuation fund members (under group life insurance policies)
policy lapse or lapse	When a policy ceases due to non-payment or cancellation by the policyholder
pre-existing medical condition or pre-	Used in life insurance contracts, this typically means an illness, medical condition or related symptom that:
existing condition	<ul> <li>was diagnosed or known about by the insured;</li> </ul>
	<ul> <li>the insured had sought or intended to seek medical treatment for; or</li> </ul>
	<ul> <li>a reasonable person should have been aware or would have sought medical treatment for</li> </ul>
	Definitions can vary across insurance contracts
Product Disclosure Statement (PDS)	A document that must be given to a retail client for the offer or issue of a financial product in accordance with Div 2 of Pt 7.9 of the Corporations Act
	Note: See s761A of the Corporations Act for the exact definition.
reg 7.1.33 (for example)	A regulation of the Corporations Regulations 2001 (in this example numbered 7.1.33), unless otherwise specified
REP 498 (for example)	An ASIC report (in this example numbered 498)
representative of an	Means:
AFS licensee	an authorised representative of the licensee;
	an employee or director of the licensee;
	an employee or director of a related body corporate of the licensee; or
	any other person acting on behalf of the licensee
	Note: This is a definition contained in s910A of the Corporations Act.
retrospective accelerator	A feature of a remuneration structure, where sales staff receive higher rates of pay after certain sales thresholds are achieved, not just for subsequent sales but for all sales already made in that period
RG 175 (for example)	An ASIC regulatory guide (in this example numbered 175)
s912A (for example)	A section of the Corporations Act (in this example numbered 912A), unless otherwise specified
term life insurance	A life insurance policy that pays a lump sum benefit if the policyholder dies

Term	Meaning in this document
total and permanent disability (TPD) cover	A life insurance policy that pays a lump sum benefit if the policyholder becomes injured or ill or is unable to work again
trauma cover	A life insurance policy that pays a lump sum benefit if the policyholder is diagnosed with a specific an illness at a specific severity
underwriting	The process used by an insurer to decide whether or not to accept a risk by entering into a contract of insurance, and, if the risk is accepted, the terms and conditions to be applied and the level of premium to be charged

### Related information

#### **Headnotes**

Accidental death, AFS licence, commission, direct life insurance, distributors, downgrading cover, general advice, group insurance, guaranteed acceptance products, incentives, income protection, insurers, LIF reforms, outbound sales, personal financial advice, policies and procedures, pressure selling, product design, quality assurance, sales conduct, sales culture, sales training, sampling, targets, term life, total and permanent disability, trauma

### Regulatory guides

RG 38 The hawking provisions

RG 104 Licensing: Meeting the general conduct obligations

RG 175 Licensing: Financial product advisers—Conduct and disclosure

RG 234 Advertising financial products and services

RG 246 Conflicted and other banned remuneration

### Legislation

Australian Securities and Investments Act 2001

Corporations Act, Pt 7.9, Div 2, s761A, 766B(3), 912A, 913B, 992A, 1041H

Insurance Contracts Act 1984

Life Insurance Act, s9

Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Power) Bill 2018

### **Consultation papers and reports**

REP 256 Consumer credit insurance: A review of sales practices by authorised deposit taking institutions

REP 454 Funeral insurance: A snapshot

REP 470 Buying add-on insurance in car yards: Why it can be hard to say no

REP 498 Life insurance claims: An industry review

REP 588 Consumers' experiences with the sale of direct life insurance

### Media and other releases

<u>17-255MR</u> Banks to overhaul consumer credit insurance sales processes (1 August 2017)

<u>18-029MR</u> ClearView refunds \$1.5 million for poor life insurance sales practices (6 February 2018)

18-150MR APRA and ASIC release new life-claims data (24 May 2018)

### Other references

ABS, 3303.0—Causes of death, Australia, 2016

ABS, 6401.0—Consumer Price Index, Australia, Jun 2018

APRA-ASIC life insurance claims data collection (June 2018)

PJC, Life insurance industry (March 2018)

Rice Warner, Life insurance aggregator review 2017