

Compliance with section 3.1 of the Life Insurance Code of Practice

**Report on an own motion inquiry into
Life subscribers' compliance with section 3.1
of the Life Insurance Code of Practice**

March 2023

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Overview



This report presents the findings of an Own Motion Inquiry (Inquiry) into subscribers' compliance with their policy design and disclosure obligations, section 3.1 of the Life Insurance Code of Practice (the Code).

The policy design and disclosure obligations outlined in section 3.1 are important protections for customers. A customer centric approach to the design and distribution of life insurance products helps ensure customers obtain products that meet their needs.

The Code requires subscribers to:

- ✓ define suitable customers for the product (section 3.1[a])
- ✓ include benefits intended to cover genuine risks that generally affect relevant customers (section 3.1[b])
- ✓ incorporate plain language into the sales and policy information and consumer-test the plain language information provided to consumers when purchasing or renewing a policy (section 3.1[c])
- ✓ ensure that policy information for policies sold directly to individuals is clear and informative for a consumer to reasonably assess the suitability of the policy for them (section 3.1[d])
- ✓ regularly review on-sale products to ensure that they remain suitable for the relevant customers and to re-design the products where necessary (section 3.1[e]).

A customer centric approach to the design and distribution of life insurance products helps ensure customers obtain products that meet their needs.

We initiated this Inquiry to obtain a clearer view of the industry's compliance with these obligations. In the four years from the industry's adoption of the Code on 1 July 2017 to 30 June 2021, the Life Code Compliance Committee (Life CCC) received no self-reported breaches of section 3.1 of the Code. We wanted to ensure industry has adequate systems, processes, and controls in place to identify, record and report breaches with section 3.1.

Issuers and distributors of financial products must comply with the design and distribution obligations (DDO) in Part 7.8A of the *Corporations Act 2001* (Corporations Act) from 5 October 2021. This change presented a timely opportunity to review the industry's compliance with its policy design and disclosure obligations under the Code.

The scope of our inquiry focused on the compliance of 18 subscribers¹ with section 3.1 of the Code in the period between 1 July 2017 and 30 June 2021. This pre-dates the introduction of the Australian Securities and Investments Commission's (ASIC) DDO. That said, we were pleased to see how many subscribers say they had already taken steps to align their practice with ASIC's obligations.

¹ Our data request was limited to subscribers who issue life insurance products within the Australian market.

What is an Inquiry?

An Inquiry evaluates a number of subscribers' compliance with a particular part of the Code. It has the following features:



a targeted and focused investigation on a particular section or area of the Code that is considered a high or emerging risk



evidence-based, proportionate, and practical



aims to also provide us with objective insights and evidence to support subscribers' compliance with the Code



aims to result in guidance and recommendations for subscribers about improving service standards and compliance.

Summary findings and context

14 OF **18**



subscribers did not report any breaches of their policy design and disclosure obligations (section 3.1).

4 OF **18**



subscribers reported four breaches of section 3.1(c) – specifically, the requirement to test the plain language information among consumers. These breaches had not been identified prior to the inquiry.

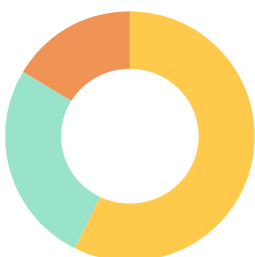


129 products were introduced by **14** subscribers between 1 July 2017 and 30 June 2021.

4 OF THE 14 subscribers introduced

106 products (82%)

Types of products introduced



57.4% Group products (74)
26.3% Direct/direct third-party products (34)
16.3% Retail products (21)

100

products were still on-sale on 30 June 2021.



Sharing good practice



Definitions of suitable customers should be clear, specific, and based on the analysis of a range of factors and information.

While Code subscribers identified very few breaches of their section 3.1 obligations, some subscribers demonstrated more sophisticated product governance arrangements than others.

Below we highlight some good practice examples that we believe will support subscribers' ongoing compliance with section 3.1 of the Code and help the industry continually improve its practice. These examples are based on our review of all the responses provided to us, including a review of their processes, policies, and procedures.

Defining suitable customers and ensuring benefits cover genuine risks

Definitions of suitable customers should be clear, specific, and based on the analysis of a range of factors and information.

Subscribers considered factors such as:

- Objectives and needs of the customer
- Demographics
- Finances
- Education
- Knowledge of insurance
- Background (occupation, age, gender)
- Financial sophistication
- Health

A well-considered definition of suitable customers is key to ensuring the product benefits cover genuine risks.

Most subscribers said that, in defining suitable customers, they considered the objectives, needs and financial situation of customers.² This included considering a broad range of demographic data.

² Since 5 October 2021, DDO has required issuers of financial products to design products that are:

- consistent with the objectives, financial situation and needs of its intended customers
- ensure financial products reach customers in the defined target market
- monitored to ensure they continually meet DDO requirements.

See ASIC's [Regulatory Guide 274](#) (RG274) for more information.

While all subscribers provided a range of information regarding the criteria for suitable customers and ensuring benefits covered genuine risks, there were some examples that demonstrated a more comprehensive and thorough approach.



Embedding regular reviews and the ability to make changes to suit a fast-changing consumer landscape is critical for subscribers to be able to meet the obligations in section 3.1 of the Code.



Subscriber A

Subscriber A had a well-documented product development procedure and governance standard.

The product concept phase was expanded well beyond the demographic data available to the subscriber. It involved (but was not limited to) consumer-testing and feedback from a range of stakeholders.

Once the product was released it was closely monitored against the original business case assumptions and the determined target market. This helps the subscriber manage and mitigate any adverse or unexpected trends early.

Embedding regular reviews and the ability to make changes to suit a fast-changing consumer landscape is critical for subscribers to be able to meet the obligations in section 3.1 of the Code.

Subscriber A accomplishes this by evaluating a range of factors when defining suitable customers and ensuring that their products

provide customers with genuine benefits, such as:

- benefits that can be tailored to individual changing needs
- products that allow for future updates to ensure objectives are always met
- consumer and market testing to obtain customer feedback
- usage of target market determinations
- conducting annual reviews of medical definitions
- incorporating medical and financial triggers for reviews
- using feedback and input from key stakeholders to update products.

The subscriber also performs health check reviews of new or modified products to ensure they are being distributed to and meeting the needs of its identified target market.



Subscriber B

Following release of a new product to market, **Subscriber B** utilises a wide range of indicators to monitor if the product is meeting the needs of the target market in addressing real risks. The subscriber's analysis took into account (among other things):

- policy lapse and cancellation rates and exploring why this was happening
- percentage of declined applications
- product claims ratios
- rate of paid, declined, and withdrawn claims
- policies sold
- customer complaints including:
 - › complaint nature and root cause

- › potential significant customer detriment
- › whether the complaint is regarding product design, product availability, claims, or the distribution condition.

Code subscribers should continue to enhance their data capabilities and draw on a wide range of performance data to identify problems and risks early. This more detailed understanding of a product's performance provides a strong evidence base for improvements. This type of close monitoring and oversight will deliver better outcomes for consumers and business.



Subscribers

Some subscribers engage external expertise to assist them in better identifying the target market for new products. This can be a great way to draw on a broader range of information, research, and analysis if these capabilities do not exist within the subscriber.

Market researchers can draw on a wide range of customer research and insights, experience and expertise, industry data and other metrics.

Market research also involves consulting with potential customers within the intended target market to gain more detailed insights and to test early assumptions to see if they are likely to meet the needs of their customers.

This approach can also help subscribers have a better understanding of the trends in the broader market. This understanding will ultimately help subscribers make more informed decisions and better define their target market.

Use of plain language and consumer-testing

Plain English ensures information is clear, informative and easy to understand. Plain English helps customers understand what it is they are committing to and how it is likely to meet their needs.

It was pleasing to see that each subscriber defined what it meant by plain language. This clarity is important so that all parts of the organisation know what they are working towards. Plain and accessible language practices continue to evolve and

improve over-time. Subscribers should continue to review their approach and strive for the best practice.

Simply having internal communications and legal teams review policy and marketing materials is not sufficient. A more comprehensive approach is required to ensure customers can easily understand the product and its promise. Some good practice examples are highlighted below.

1. A number of subscribers engaged third-party specialist plain language consulting services to design their Product Disclosure Statement (PDS), policy documents and other customer-facing written material. Engaging external specialists with the appropriate expertise can be a good way to ensure that the information communicated to consumers is clear, informative, and easy to understand.
2. **Subscriber C** introduced a policy to encourage the use of plain English. The policy sets out a number of plain language principles expected to be applied to all customer-facing written communication. The guideline focuses on the use of simple words and phrases, using a clear tone, forming short sentences by including only the necessary information and the use of active voice. This comprehensive approach allows the subscriber to ensure that a consistent approach to plain English was adopted across all communications to its customers.
3. In the instance where technical terms are necessary, such as the use of medical terms or definitions in some policy documents, subscribers provided examples throughout the PDS to assist customers. The examples made it easier for customers to understand complex terms and definitions.
4. When reviewing and re-designing customer communications, **Subscriber D** used the services of behavioural scientists to improve customer experience and understanding beyond just the use of plain English.

Subscribers must have processes in place to test whether their correspondence is in plain language. Specifically, section 3.1 requires subscribers to consumer-test the information provided to consumers when a policy is purchased (section 3.4) and the annual notice letter sent prior to the anniversary of the policy (section 6.3).

While the Code does not specifically require consumer-testing to be done by external expert consultants, relying on experts with experience in this field would be considered good practice. Good practice examples include:

- 1. Subscriber E** conducts consumer-testing on PDS, marketing material and consumer correspondence. Consumer-testing is undertaken by expert consultants. Consumer-testing includes large scale surveys (in excess of 1,000 participants), focus groups and one-on-one consumer interviews.
- 2. Subscriber F** surpasses the Code's requirements by engaging an external market research company to perform consumer-testing research. This research is comprehensive and involves gathering feedback from customers, advisers, and the general market prior to and after the launch of the product. Subscriber F prioritises incorporating the feedback received into their product improvements. The consumer-testing research encompasses identifying the critical decision-making points for customers when choosing an insurance provider, comprehending the obstacles associated with life insurance, and evaluating the attractiveness of their product offering.
- 3. Subscriber G** principally conducts consumer-testing through external research agencies. Consumer-testing typically involves using indepth one-on-one customer interviews or online surveys. The consumers tested are selected from the target market and include different age groups, genders, existing and prospective customers. During one-on-one interviews, customers are provided with policy documents and are asked to locate key information. Customers also provide feedback on how the documents could be improved.
- 4. Subscriber H** commissions an annual consumer survey by an independent agency of more than 1,000 Australians between 30 and 60 years old. The yearly survey provides more regular market feedback when compared to other insurers who seek consumer-testing when new products are introduced, or major changes are made to existing products.

Conducting Regular Reviews

It was pleasing to see that subscribers had ongoing review processes in place to review new products. With ongoing advances to data analytics and business intelligence reporting, subscribers should be drawing on a wide range of key risk indicators. This includes customer complaints, lapsed or cancelled policies, declined claims in order to identify potential risks and inform improvement.

We observed that most subscribers would conduct reviews every 12 months to 3 years, with some subscribers conducting reviews early if the operating environment changed. Some good examples of how subscribers conducted regular reviews are shared below.

- 1. Subscriber I** did not standardise the length of product review periods. Instead, the products' risk rating was taken into account. Subscriber I's risk assessment was based on a variety of data. In this assessment, the customer value proposition was evaluated, taking into account a variety of factors, including:
 - alignment of processes to the customer needs
 - alignment of costs and benefits to customer expectations
 - costs aligned to value relative to alternative in-house offers
 - clear communications
 - the extent to which the product is meeting expectations to deliver on its promise
 - complaints data
 - barriers to switching (e.g. waiting periods).
- 2. Subscriber J** uses a broad range of data to conduct product reviews, such as:
 - experience analysis data (lapses, cancellations, and claims)
 - complaints register (by type and volume)
 - claims type and volume
 - declined claims data
 - DDO register
 - sales data
 - customer and adviser feedback
 - market assessment.
- 3. Subscriber K** conducts regular reviews of an ongoing process to ensure customer needs are met and performance is improved. Additionally, Subscriber K conducts regular product reviews to adapt to changing regulatory requirements. If any of the products offered fail to provide value to customers and result in low uptake, Subscriber K will either improve the existing product design or remove the specified cover from the offer.

Scope of section 3.1

Section 3.1 of the Code applies to all products (both on-sale and off-sale) a subscriber designed and introduced after it adopted the Code.

HOWEVER, THERE ARE EXCEPTIONS:

- The obligation to consumer-test the plain language information (section 3.1[c]) does not apply to group³ or Consumer Credit Insurance⁴ (CCI) policies.
- The obligation to ensure that policy information is clear and informative (section 3.1[d]) does not apply to policies sold via a financial adviser or planner, or to policies with a group policy-owner.
- The obligation to regularly review products (section 3.1[e]) only applies to on-sale products.
- Depending on the arrangement that a subscriber has with the group policy-owner, the obligations in section 3.1 may not apply to group policies. For example, a subscriber may not have control over defining suitable customers for the product, the benefits offered, or the sales and policy information of the product.

Data collection

WE COLLECTED INFORMATION FROM 18 SUBSCRIBERS ABOUT:

- on-sale⁵ and off-sale⁶ products introduced between 1 July 2017 and 30 June 2021
- four breaches of section 3.1 of the Code between 1 July 2017 and 30 June 2021.
- processes and procedures for complying with the obligations in section 3.1 of the Code

3 'Group': consumer-testing does not apply to the plain language information in section 3.4 and 6.3 for group policies.

4 'CCI': consumer-testing does not apply to the plain language information in section 6.3 for CCI policies.

5 Products currently on-sale.

6 Products currently not on-sale.

Each subscriber was asked to provide responses to the following 13 points via a questionnaire:

1. The number of products introduced by the subscriber between its adoption of the Code and 30 June 2021.
2. A list of the products designed and introduced by the subscriber, including whether the subscriber had completed the various obligations created by section 3.1 of the Code.
3. The factors that the subscriber considered when defining suitable customers, as well as the subscriber's process for defining suitable customers.
4. Reasons why the subscriber had failed to define suitable customers (if applicable) and whether this amounted to a breach.
5. How the subscriber identifies genuine risks which generally affects the relevant customers of its products.
6. Reasons why the subscriber's products failed to include benefits intended to cover genuine risks (if applicable) and whether this amounted to a breach.
7. How the subscriber defines plain language and the subscriber's process for incorporating plain language into the sales and policy information.
8. Reasons why the subscriber failed to incorporate plain language (if applicable) and whether this amounted to a breach.
9. Information on the type and scope of consumer-testing done by the subscriber and the subscriber's process for conducting consumer-testing.
10. Reasons why the consumer-testing was not completed (if applicable) and whether this amounted to a breach.
11. How the subscriber ensures that the policy information is clear and informative.
12. Reasons why the subscriber failed to ensure that the policy information was clear and informative (if applicable) and whether this amounted to a breach.
13. Information in relation to the subscriber's process for regularly reviewing its on-sale products, including how often the review is done and how the review is completed.

Detailed findings



DEFINING SUITABLE CUSTOMERS

- All subscribers confirmed that they either had defined suitable customers for their products or had not issued any products within the relevant period. There were no reported breaches of this obligation.
- In defining suitable customers, subscribers typically considered a combination of the following factors:
 - › Demographics
 - › Finances
 - › Education
 - › Knowledge of insurance
 - › Background (occupation, age, gender)
 - › Financial sophistication
 - › Health
 - › Objectives and needs of the customer
- The Code does not include an obligation relating to the quality of the definition of suitable customers. However, subscribers should still use appropriately detailed and tailored definitions of suitable customers for their products.
- While some subscribers considered a wide range of factors when defining suitable customers, other subscribers defined suitable customers based on only two or three factors.
 - › A definition of suitable customers which is only based on two or three factors is unlikely to accurately reflect the suitable customer and contain the detail required.
 - › Consumers have diverse needs. Relying on just two or three factors is likely to lead to a broad definition of suitable customer and is likely to increase the risk of consumers being sold inappropriate or inadequate products.
 - › While this is technically not a breach of the Code, in our view this approach does not align with the spirit of the Code. It reduces the definition of a suitable customer to an administrative exercise instead of a meaningful way to ensure customers obtain cover that meets their circumstances.
- Subscribers should employ as many factors as possible when defining suitable customers. The use of a wide range of factors assists subscribers in having a definition of suitable customers that is as accurate as possible.



BENEFITS COVERING GENUINE RISKS

- All subscribers confirmed that they included benefits to cover genuine risks with the products they designed and introduced. There were no reported breaches of this obligation.
- Subscribers noted that these genuine risks were typically identified through a combination of:
 - › regular product reviews
 - › monitoring claims and complaints
 - › feedback from customers
 - › research and testing
 - › reviews
 - › knowledge from internal and external subject matter experts.
- Whether benefits cover genuine risks depends on how the subscriber defines suitable customers. Subscribers should review their policies regularly to ensure that the benefits offered continue to cover genuine risks since they can change over time for the target market.
- According to section 3.1 of the Code, subscribers are obligated to provide benefits that address real risks. Since a product typically contains several benefits, adherence to this section necessitates that all benefits within the product address genuine risks that the target audience may encounter. It is not satisfactory to have only one benefit that addresses a legitimate risk. The obligation to include benefits covering genuine risks is closely tied to the obligation to define suitable customers; subscribers will only be able to provide benefits covering genuine risks if the suitable customer for the product is adequately defined.



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USE OF PLAIN LANGUAGE

- All subscribers confirmed that they incorporated plain language into their sales and policy information. There were no reported breaches of this obligation.
- Most subscribers had defined plain language in a broadly similar way. However, there were slight variations in the definitions used and there was no single consistent definition of plain language across the industry.
- Several subscribers used external consultants to help with incorporating plain language in their communications. Subscribers also provided plain language training to their customer-facing staff and staff involved in product design.
- We recommend that the industry develop and adopt a consistent definition of plain language as the Code lacks one. A possible example is from the Plain English Foundation's Australian Style Guide:
 - › 'A communication is in plain language if its wording, structure and design are so clear that the intended readers can easily find what they need, understand what they find and use that information.'
- A standard definition of plain language adopted by industry would demonstrate the commitment that the industry has to plain language within its communications. This would provide a consistent standard by which to determine whether a communication was in plain language.



CONSUMER-TESTING

- Section 3.1 of the Code requires subscribers to test the plain language used in information about new policies and renewals with consumers (section 3.1[c]).
- Four subscribers reported four breaches of section 3.1(c).
 1. Subscriber L acknowledged a breach because it did not conduct testing for a product it sold via a distribution partner. In error, it assumed that the product's predecessor had already been tested. The product was on sale between July and November 2020, and the breach related to 3,320 policies. Subscriber L confirmed that it no longer sells policies via this distribution partner.
 2. Subscriber M acknowledged a breach because it only tested part of the information provided in the customer information pack. This affected 6,477 customers between

13 August 2019 and 13 February 2022. It noted that the breach occurred because it believed that it was not reasonably possible to test the information on a customer-by-customer basis. We have confirmed with Subscriber M that the consumer-testing required does not include testing the information of individual customers. Instead, compliance with this obligation could be achieved by testing the templates used to communicate this information to customers.

3. Subscriber N acknowledged a breach because it was not able to locate records confirming that it had tested information for three products it issued since adopting the Code. It assessed the matter as a significant breach of the Code and reported it on 9 June 2022. Subscriber N also reported this breach to ASIC under section 912A(1) of the *Corporations Act 2001*.
4. Subscriber O did not acknowledge a breach of section 3.1 within its submission but reported that consumer-testing was not done across 20 products (33 instances). Following a meeting with Subscriber O to discuss this issue, the subscriber reported a breach of section 3.1 in relation to the 20

products where consumer-testing was not done. Since reporting this breach, Subscriber O has conducted further targeted consumer focused work for the relevant products.

- The Code does not include a requirement in relation to the frequency of consumer-testing. Despite this, subscribers should ensure that consumer-testing is conducted whenever significant changes are made to the information required in sections 3.4 and 6.3.
- We would consider significant changes to be any changes that materially alters the way that the information is provided to consumers. This would include changes to the way the information is structured or amendments to the design of the communication.
- Some subscribers conducted consumer-testing for other aspects such as the sales process or website user experience. While this is not explicitly required by the Code, we welcome this as good practice and beneficial for customers.
- Subscribers can perform consumer-testing on their own or through an external agency. Testing should include a sufficiently diverse cross-section of the target market.



CLEAR AND INFORMATIVE

- All subscribers confirmed that the policy information provided to their customers was clear and informative. This allowed the customer to make informed decisions regarding the appropriateness of the policy.
- However, this does not align with the ‘on the ground’ experience reported to us by consumers and consumer advocates. Customers often complain that life insurance products are too complex and difficult to understand. Products have complex medical definitions and often have multiple exclusions or industry jargon that can be confusing to consumers.
- Subscribers can simplify policy information by regularly testing it with consumers and evaluating their understanding of the policy details. Subscribers should also seek regular feedback from consumers to ensure that the information provided to consumers is clear and informative.
- While this may not always be possible, we encourage subscribers to continue to strive to simplify policies. Subscribers should streamline their policy offerings to assist consumers in choosing the appropriate product that meets their needs.



CONDUCTING REGULAR REVIEWS

- While section 3.1 requires a subscriber to regularly review its on-sale products, the section does not set a timeframe for a regular review. Subscribers typically reviewed products annually or once every three years, with the longest being a review every five years.
- We consider five years to be too infrequent. This puts on-sale products at risk of being out of line with consumer changes and shifts in community expectations.
- As a matter of best practice, subscribers should review their on-sale products as often as appropriate in the circumstances to ensure that the products remain fit for purpose and continue to meet the needs of the target market.



We consider five years to be too infrequent. This puts on-sale products at risk of being out of line with consumer changes and shifts in community expectations.

Appendix 1

Subscribers who provided responses as part of the Life CCC's Inquiry:

1	AIA Australia Limited
2	Allianz Australia Life Limited
3	Asteron Life & Superannuation Limited (Code Subscriber until 30 September 2021, fully acquired by TAL Life Limited)
4	Clearview Life Assurance Limited
5	Hallmark Life Insurance Company Limited
6	HCF Life Insurance Company Limited
7	Hannover Life Re of Australasia Limited
8	Integrity Life Australia Limited
9	MetLife Insurance Limited
10	MLC Limited
11	NobleOak Life Limited
12	OnePath Life Limited (Code Subscriber until 31 July 2022, fully acquired by Zurich Australia Limited)
13	Resolution Life Australasia Limited
14	Swiss Re Life & Health Australia Limited
15	TAL Life Limited
16	TAL Life Insurance Services Limited (ex Westpac Life Insurance Services Limited)
17	The Colonial Mutual Life Assurance Society Limited (Traded as CommInsure, acquired by AIA Australia Limited) (Code subscriber until 31 March 2021)
18	Zurich Australia Limited



Life Code Compliance Committee
lifeccc.org.au