



Michael Vrisakis Hi everyone. I'm Michael Vrisakis, a Partner in the Herbert Smith Freehills Financial Services Team. Welcome to our podcast series called the FSR GPS. This series focuses on topical and emerging issues in financial services regulation which we think are the most strategic and important issues for our clients. Feel free to suggest topics you would like us to cover in the future but for now, we hope you enjoy today's episode.

Tamanna Islam Hi, I'm Tamanna Islam, a Senior Associate in the FSR team here at HSF, with a focus on insurance, superannuation and financial advice and distribution. I am joined by Michael Vrisakis, who I work with very closely and who is a Partner in the HSF FSR team with a particular expertise in, and I think safe to say, an addiction to developing regulatory strategy. Hi Michael, thanks for joining me.

Michael Vrisakis Thanks, Tamanna. Hi everyone. Yes, I think in terms of developing regulatory strategy, what we're seeking to do is to influence the trajectory of that regulatory strategy and we're going to be talking about some of those aspects today, particularly in relation to the concept of fairness, but it's great to be speaking with you today and look forward to discussing some of these topical issues that we're finding are coming up in our client base with a lot of regularity. Over to you, Tamanna.

Tamanna Islam Thanks, Michael. Yeah, so we thought we would have a pretty informal conversation today about the state of the insurance sector in Australia, including current trends and some predictions on where we think it's going. Insurance is currently, and it has been for the last few years since the Royal Commission, going through what can only be described as an intense regulatory cycle and it's our clients in the insurance sector, be they general insurers, life insurers, or distributors and brokers, they are actually occupying a lot of our time with an enormous breadth of legal issues and challenges, but also new exciting projects and innovation.

Michael, you've had a long love affair with insurance. What are you seeing as the key issues on the radar for the insurance sector today?



Michael Vrisakis

Well, I think Tamanna you've raised a really good point. Post-Royal Commission, I think superannuation, advisers fees etc, were really the big items. But I think we're now seeing a real focus on insurance and an accentuation and absolute evolution of some of the regulatory focuses on the insurance sector. So it really has become sort of the flavour de jour if you like. So the issues we're seeing, some of the obvious ones such as the unprecedented package of law reform for the insurance sector that commenced in 2021 and we've had an unprecedented volume of changes affecting insurance such as unfair contract terms, DDO, breach reporting, anti-hawking, deferred sales for add-on insurance, claims handling, being I guess the principal ones. But what you are seeing is absolutely this focus post-Royal Commission on consumer outcomes and allied with that is this definite focus on consumer expectations and value, which you remember was one of the drivers in the Royal Commission.

So what does this all mean for the industry and for the client base that we are servicing? Well, we are seeing really a very much increase in ASIC's enforcement cycle in relation to insurance. We're really seeing it flexing its arsenal and its regulatory muscles at the moment. And not, I don't say inappropriately when I say inappropriately, because I think if the regulator is now focused on insurance, clearly they're going to be going through a number those different factors that I mentioned earlier. But the tools which they're using to look at insurance are probably not surprising. Licence conditions, which they've used in other context, stop orders, test cases. Now just pausing at test cases, people will be aware I think that there have been two interesting cases that ASIC has launched against a general insurer on the one hand and a life insurance on the other in relation to unfair contract terms in insurance with an emphasis on the correlation between disclosure in the product disclosure statement and elsewhere, and the actual rights, statutory rights, that exist particularly under the Insurance Contracts Act. So they want to make sure that those rights under the Insurance Contracts Act are adequately and properly appropriately disclosed in the PDS.

But beyond that, we're seeing clear invisible trends that others may not necessarily see unless you're being directly impacted. There are some serious regulatory wrangling going on with ASIC and APRA behind closed doors. APRA's obviously looking at sustainability, ASIC's looking at consumer rights. We've also seen, for example, in the area of level premiums absolutely a focus by ASIC on disclosure and misleading and deceptive conduct, but it's fair to say we're also seeing quite a lot of DDO activity as well.



A lot of our insurance sector clients, including both insurers and brokers as well as distributors, are coming to us to navigate what I think Tamanna and I would say is the most complex regulatory landscape that we've seen and seeking that assistance to navigate and to I guess, you know, sort of use this concept of regulatory wrangling or regulatory kind of navigation to see how they can make sure that they're on the right side of the regulatory line.

Tamanna Islam

Yeah, that's right. And there's quite a lot of uncharted territory we're definitely seeing in the enforcement space and notwithstanding all of this enforcement, Michael, you mentioned regulatory reform. The reform hasn't actually stopped. We've had an unprecedented volume of changes as you say. But there's actually more coming. There's the financial accountability regime and the new prudential standard on operational risk management, to name some key ones. But I'd like to talk a little bit more about this regulatory wrangling scenario that you mentioned. Because this is actually an area that can have a profound impact on an insurer and indeed brokers and distributors. Can you talk us through some of what you are seeing here?

Michael Vrisakis

Well, I think in terms of regulatory wrangling, which is really in some ways a shorthand for the relationship which a particular insurer, broker or distributor will have with ASIC, in particular, but also APRA, we're seeing the importance of a trusted relationship between the institution and the regulator assume unparalleled importance. And that's because the regulators on the one hand are very keen, as you might imagine, to make sure that consumer's rights are protected. On the other hand, we're seeing, because of this regulatory complexity, if there is non-compliance it's inadvertent and arguably, there isn't non-compliance in circumstances where there may be complex legislation where reasonable minds can differ as to the interpretation.

So the importance ironically for interaction with the regulators, is unparalleled in itself and yet the regulators are not necessarily going to engage to the extent that the institutions might like. And by that I mean that obviously the regulators aren't going to give legal advice, they're not going to white board or approve stuff. They're going to say "look, you know, you get your own legal advice". And it's important that people do understand how this complex regulatory matrix works. Because there's a lot of complexity that is sewn into this regime and we're seeing more, as Tamanna mentioned, as things go on and more reforms usually means more



complexity. Rarely, does reform necessarily equate to reduced complexity. It's usually just additional layers of regulation, as Tamanna mentioned.

So in terms of concrete examples, we're seeing ASIC apply significant regulatory pressure on insurers and distributors and again I stress not inappropriately, but which falls outside often in the areas of strict enforcement. So ASIC has got both an arsenal of strict legal tools but also, in terms of its broader mandate, it's obviously keen to ensure that the insurers and the other protagonists we mentioned who play in this field basically conform with relevant industry values and, I mentioned earlier, consumer expectations. So that might mean that the regulators would take a certain stance towards remediation or may indeed want the relevant player to cease certain business operations if it just doesn't feel comfortable with the regulatory stance, or the regulatory position, that that institution has taken. And that's often where we get involved in terms of just assisting and usually it's with, absolutely with cooperation with the regulator, to work out what is the right line, what is that right dividing line?

So typically our clients take that sort of attitude of ASIC very seriously. Because basically you want to have a good, transparent and trusted relationship with the regulator, whether that be ASIC, whether that be APRA. So ASIC does have that power, but often it doesn't necessarily need to go into enforcement mode because just talking to the clients about its expectations can often have that effect. And of course from a client point of view, we need to help clients make the right call as to what they should agree to and what maybe they need to, if I may say, negotiate, if we may say negotiate, with the regulator. Or at least get to, you know, get to the same page as a regulator, if possible, from a regulatory point of view.

On the APRA side, this is where it can get really hard because given the breadth of what APRA's mandate is, and again totally appropriate, but it has got potentially huge ability to impact on the capital of an institution. In the last 12 months, we've seen multiple instances of APRA wanting to impose licence conditions or capital charges or other changes which are not favourable to an entity's risk rating or governance requirements and this is often compounded with greater activity from APRA, the ability for APRA to actually go more actively into the organisation. So, for example, requesting access to board documentation will be an example of its greater accessing, you know, the internal workings of the organisation, legal advice, accessing that, other internal papers. Some of these matters are of course subject to legal boundaries like legal privilege, for example. But often, again, our clients see that there's a value in providing those materials to APRA from



the point of view of enhancing the relationship, the trust relationship, that they do have with the regulator.

So these are matters that can have a profound impact on the viability and sustainability of an insurance business, but there must be a right balance, and I guess that's part of what Tamanna's referred to as regulatory wrangling or, you know, this regulatory interface that we assist our clients with.

Tamanna Islam

That's right, Michael. I think, you just mentioned viability and sustainability then. I mentioned earlier that the regulatory reform in the sector hasn't actually paused at all with more coming down the pipeline and this has been one of the key factors impacting on sustainability, I think. I don't think anyone can dispute the need for a comprehensive and well-functioning regulatory regime. As you've said many times, it's entirely appropriate in many cases and this is their design to protect the interests of Australian consumers. And insurance does continue to be one of those perennially sort of misunderstood areas with pretty low financial literacy across the country and there's also a lot of adverse public and media scrutiny on insurance as well.

So there is quite a bit of work that needs to be done here, both by the sector, but also by regulators and government from a policy perspective. I will say that the piecemeal and persistent manner of reform in recent years has led to some considerable inefficiencies in the operation of insurance. The individual and cumulative effect of these changes are considerable. And those in the insurance sector continue to need to divert material resources to the implementation of ongoing and piecemeal reform which continues to contribute to a resource strain in the insurance sector. And this can sort of contribute to diverting important resources away from the exploration of new product innovation and new business initiatives that are designed to meet consumer demands and needs. And this innovation is even more important now I think in going forward given the sustainability issues in insurance which are affecting pricing, claims ratios, capital sustainability and, most importantly in some respects, consumer affordability. We seem at the moment to be locked in an endless cycle of rising premiums and capital sustainability challenges.

Michael Vrisakis

Yeah, I mean I guess there's a lot that can be said to unpack. There's a lot of different issues that are coalescing in this landscape. Clearly



environmental, which is self-explanatory in terms of weather conditions and adverse events from that point of view. But the second bucket is really economic. I mean, we're in a rising inflation cycle. It obviously impacts on the investment growth of capital investment by insurers which in turn impacts on capital sustainability and capital buffers. But the third is legal and regulatory, and that is often overlooked. But the fact that the legislation may be complex, the fact that the legislation may, as in many cases in the life insurance context and life insurance supporting superannuation, lead to black and white situations where it's either the insurer has to pay the benefit or it doesn't have to pay the benefit but in circumstances where, for example, as in total and permanent disablement, you know, it shouldn't be that binary or there may and there should be situations in which the regulation can help to make sure that the appropriate benefit is being paid and not being overpaid to relevant consumers.

Tamanna Islam

Yes, there are a few aspects of this legal and regulatory bucket arm there that contribute to sustainability issues. One you've mentioned, Michael, around sort of the circumstances in which the insurer is required to pay out benefits. Another aspect is the piecemeal reform that I mentioned a little bit earlier and the need to continually divert resources to implement this reform. But, importantly, the other aspect of this continuous reform is that it has actually given rise to some ambiguity in some key areas of law, such as financial advice, such as anti-hawking, which also contributes to resource strain as insurers are trying to continually decipher their obligations and operate in a way that is compliant.

Michael Vrisakis

Yeah. So I mean the other critical, important phenomenon here is AFCA, and we're seeing increasing prevalence of that, of AFCA's interaction with our clients. And basically it's not surprising because there's obviously, AFCA's got a very, very broad jurisdiction. And that can in fact impact on sustainability and, particularly, in terms of premium increases across the sector and across our client base. And that's because, as I said, it is not just a jurisdiction about legal compliance but it also encompasses fair and reasonable issues. And that expansive jurisdiction of AFCA can mean that our clients may have been legally totally compliant, but they're subject to differences of opinion as to what's fair and reasonable in the circumstances, that can add to this whole issue of consumer expectations as well.

So what it means increasingly, I think invariably, is that insurers are required to pay out claims that are, and benefits which are, often beyond the



parameters of the strict legal requirements under the insurance contract. So that affects areas like premium variation powers. We've seen that in the level premium space as well as in the interpretation of, as I mentioned earlier, key aspects of the Insurance Contracts Act. So it may not seem that significant although I'm sure a lot of our clients do see these things as significant when you consider that it can actually have an impact in relation to cohorts of consumers. In other words, where the view is that there is a systemic or a cohort impact as often there will be, so for example, in relation to level premiums. So it does give rise to a range of unanticipated issues. And we are seeing this really having a very material impact on some of our insurance clients who are required to pay out quite significant sums in terms of remediation beyond the contract. And of course, remediation is an expensive exercise, AFCA's got powers to refer matters to ASIC, and obviously there's this issue of systemic compliance as well.

Tamanna Islam

So this can be quite a tricky exercise as you say as well from an actuarial perspective because the scope of the insurance cover is the product of a carefully crafted balance between the insuring clauses, the exclusions and the conditions under the insurance policy. But if the insurer is actually routinely required to pay our clients in benefits beyond what would be covered under the parameters of the insurance policy, you can definitely start to see how this is going to start impacting on the insurer's cost space, its capital position, its premium pricing and ultimately sustainability of the insurance.

Michael Vrisakis

Yeah, that's right Tamanna. I mean, particularly in the context of what is essentially an insurance product which is all about pricing and actuarial assessment of risk. So you're quite right. That's definitely having unintended impacts in relation to the pricing and the actuarial component of the policy underwriting. But it's important to consider I guess in the context of AFCA and going back to an earlier comment about the regulatory trajectory, the concept of fairness, really needs to be looked at closely because it is a key jurisdictional matter and power for AFCA. But we take the view that fairness actually has got two sides to it. It's not just fairness to the consumer, but it's fairness to the insurer as well. And comments to this effect have been made in Federal Court judgements where in the context of the requirement to act efficiently, honestly and fairly, fairness does mean fairness to both parties.

So in our view, we really need as an industry to push the barrel that in terms of AFCA, in terms of efficiently, honestly and fairly obligation that you need



to look at it from the point of view of both parties, both the fairness to the consumer and fairness to the insurer. So in other words, the interest of the consumer should not be considered in a vacuum. And we are, as I said earlier, seeing judges recognise that in a welcome move from a case law perspective, and hopefully that can extend to AFCA as well of this duality of the concept of fairness.

Tamanna Islam

That's right. And this, this sort of burgeoning body of Federal Court law is actually a really important body of law that AFCA can definitely have regard to because there are some really interesting and useful principles on fairness that are extrapolated in those cases. Essentially sort of giving further light to this concept that you talk about, Michael, that fairness is essentially a two-way street. It's to both sides of the equation. Not only to the consumer but also to the insurer.

So, sustainability is obviously going to be an ongoing challenge over the coming years for the insurance sector. The APRA sustainability measures as you know are temporarily on hold but it's clear that sustainability is a problem that will need to be tackled by industry, by ASIC, by APRA and the government. It's not an issue that's going to go away and it's also not an issue that the industry can simply self-correct.

What other challenges or trends do you foresee coming over the next few years, Michael?

Michael Vrisakis

Well, I think definitely the cyberspace is really important in this regard – cybersecurity frauds and scams, integrity of data. That's going to continue to be a challenge from a pragmatic point of view, but it's clearly going to be the subject of further regulatory scrutiny by both ASIC and APRA. And whilst both of those entities are looking at making sure licences focus on strengthening their cybersecurity in scams, in the insurance industry, it certainly won't be immune to that. And I think the interesting aspect is to what extent that's going to be dealt with by existing legislation or prudential standards in the case of APRA or whether there's an evolution through general obligations like efficiently, honestly and fairly which we mentioned earlier. To what extent can that general obligation be used to enforce issues around cybersecurity.

I guess an interesting aspect of cybersecurity does involve a legal issue, and that's whether an insurer's existing insurance policies contemplate what will occur to benefit payments in the event of a cyber incident. By that, what



we're talking about is where data is compromised – how does that affect the obligation of the insurer to continue to make benefit payments where there is obviously a risk that the payment is not in fact received by the intended recipient. Will the insurer be able to temporarily suspend the payments? Can we argue implied terms of the contract? Can we argue frustration from a legal perspective? And we're starting to see at least some insurers grapple with this legal problem because in our review of policy wordings, most policies don't seem to contemplate, and perhaps understandably, as a matter of contract, what can be a significant impediment from them paying securely benefits to policy holders. And of course from the point of view of general sort of obligations to act in good faith and to give priority to policy holders in the case of life insurance, you'd think that those sorts of, the security factor in terms of making sure that the right people get the benefit would be an important consideration from those more general, protective obligations in various pieces of insurance legislation.

So I mentioned frustration, but it's important to note that the doctrine of frustration more often than not, will not be available. So we need to look to increasingly future-proof contracts and our disclosure around this evolution that's occurring not just in the area of cyber but obviously in other areas as well.

So on the flip side of technology there's clearly also an increasing demand in market for entirely digitised products, digital convenience and we are seeing innovation not surprisingly. And I'm sure there are various operators overseas and there are various institutions that are owned globally who will be seeking to implement more digitalised servicing as these years progress – well I suppose in the very near future. And that can extend obviously to simplification of claims handling as well.

Tamanna Islam

Yeah. And I mean, you mentioned 'data' a little bit earlier. Insurers hold and gather immense volumes of consumer data which can help them identify needs and gaps in the market and use it to innovate new products. We're definitely seeing some exciting new concepts in innovation in this space, including actually increased product tailoring and functionality so that consumers are only paying, for example for the insurance that they need. But this has actually been quite an interesting area, this concept of product-tailoring, and it's not without some regulatory friction. We're often seeing sort of insurers, distributors and brokers try to increasingly deliver tailored product propositions for customers based on trends identified by using data. But inevitably, these initiatives end up needing to grapple with the



restrictions and ambiguities of I think what can only be described as the embattled financial advice regime in Australia. So I suppose there's hopefully some relief here with the federal government recently accepting many of the recommendations of the quality of advice review which have the potential to have quite a transformative effect I think on insurance distribution. And we know from our discussions with many of our clients in the insurance sector that they welcome many of the quality of advice recommendations, but it's important to remember that there are some key limitations here as well. Under the current proposals for example, the making of a recommendation while holding data would *prima facie* trigger personal advice. And this expansion raises some tricky issues for the insurance industry who, as I mentioned, insurers hold considerable data about individual clients and their risk profiles. And this data is actually essential to the identification and pricing of the risk that the insurer is going to underwrite.

So at a minimum, the insurer will hold data about, let's say the customer's age, gender, postcode, their claims history and the proposed expansion of the concept of personal advice will mean that all personal interactions with the customer seeking or asking questions about insurance could actually constitute personal advice. So that would actually be quite a dramatic expansion, Michael.

Michael Vrisakis

I think that's a really important note to sound, I mean the reality is that we are introducing and you'll see this on our website portal which is HSF FSR Notes, the introduction of a regulatory awareness program for our clients in which we're going to seek to identify real risk areas that can affect our client's business into the future. And I think advice is one, because I just think that in the wake of the Westpac and ASIC decision in the High Court there's clearly, as Tamanna mentions, a real risk that insurers, by virtue of just holding the information are going to be held to be deemed to be providing personal advice or couldn't be expected to provide personal advice. So that is one absolutely to look for.

The other trends we're seeing are really structure ones. The gap in terms of M&A activity were short-lived, I think it's fair to say. And insurers continue to be really active in terms of what we're seeing in the space. We're seeing a lot of acquisition, divestment activity focusing on scale, consolidating in order to gain further scale, expanding core businesses through acquisitions and divestment of non-core businesses, again in terms of the ever-enduring quest for profitability and scale. One challenge here continues to be insurers



being able to drive the benefits consolidation through systems integration, rationalisation of legacy books and minimising lapse risks. You'll be aware no doubt, some of the listeners will be aware, that periodically the government has sought to introduce product rationalisation facilitation legislation which has not happened. So at the moment, the only real way of doing it without consumer consent, which is difficult, is through the use of insurance schemes both in the general and in the life insurance space where they can play an important role in terms of opportunities to rationalise product terms without policyholder consent. And I think just in terms of the regulatory awareness program I mentioned earlier that we're going to see an enhanced use of schemes to affect product rationalisation because they have not been used in a very, very prevalent way, and that is likely to change in our view.

Tamanna Islam

Yeah, I think that's absolutely right. I think from a structural perspective, the other interesting trend is actually the rise of new entrants in this market. So that's kind of the flipside of this consolidation and legacy rationalisation issue. These new entrants in the insurance market generally fall into two categories in terms of what we're seeing.

So the first category is sort of foreign domiciled insurance conglomerates that are expanding into the Asia Pacific region. So they might be sort of global insurers, and this is happening either organically with the foreign insurer either setting up a new shop here or otherwise through acquisitions, linking back to the M&A trend that you just mentioned, Michael.

The second group of entrants are what I refer to as essentially the disruptors or the dabblers. And these are essentially existing large businesses in the Australian market or from overseas that are diversifying into insurance. So for example, we're seeing energy companies, travel providers, tech start-ups just to name a few, all entering or showing an interest in entering the insurance market and experimenting with different product and service bundling propositions, and white-labelling does continue to be a key mechanism through which this is achieved. And what this means is I think what you and I have definitely seen, Michael, over the last little bit, is that the nature of the legal advice we're actually being asked to provide is self-evolving and we're now advising on the full spectrum of market participants, be they the established sort of juggernauts as well as the new entrants and disruptors and dabblers.

And as you would imagine, no doubt there is also a full spectrum in terms of the sophistication of these clients when it comes to the legal and regulatory



regime, and this is something that ASIC and APRA will no doubt have to grapple with as well from a sector perspective.

So I guess, Michael, to round us out for today, your key focus areas in the insurance sector for the next few years?

Michael Vrisakis

Well, I think it's sustainability which you mentioned earlier, Tamanna, but I think future-proofing contracts of insurance and disclosure documents is really important. And that is to do a couple things. One is to make sure that you address some of these regulatory issues that are arising in terms of disclosure. We mentioned ASIC looking at disclosure in terms of aspects of the Insurance Contracts Act and how they gel and mesh with disclosure documents. So being pro-active in terms of reviewing your documents which people have to a large extent already been doing in terms of the unfair contracts regime but continuing that trend to make sure that your documents are flexible, supple and also are going to be, I guess, insulated against some of these regulatory trends.

I guess the next point really to make I suppose is really a regulatory and legislative point. And that is that sustainability does mean that there should be some ability of the government or some obligation, if you like of the government to actually make sure the legislation is going to enhance sustainability. So for example, in relation to product rationalisation I mentioned earlier, that would be hugely, hugely valuable if the government could come to the party even though it hasn't, there hasn't been any really active developments and material developments in that area. But given the regulatory complexity through these added layers of regulation, product rationalisation facilitation through a legislative facilitative regime would be absolutely fantastic and I think is really vital.

Tamanna Islam

Yeah, I think that's exactly right. And on my end while we're on the topic of the government sort of coming to the party with some legislative solutions, I'll be keeping a keen eye out for reform in the financial advice space in a way that can hopefully make insurance much more accessible and well understood in the Australian market. And I think just in terms of the market dynamics for a new entrant in the market is also a key, watch this space from my perspective. But I think that's probably all we have time for today. Thanks for listening in and thanks, Michael, for joining me.



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Michael Vrisakis

I guess it's also relevant, guys, if anyone out there has got any other suggestions or any other areas of interest in relation to the insurance sector in particular, please come back to Tamanna and myself and let us have your ideas because we're really keen to make sure that you get the maximum value out of our podcast series.

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