



**ASIC**

Australian Securities & Investments Commission

## **Annual Insurance Council of Australia Conference**

*An address by Jillian Segal, Deputy Chair, ASIC, to the "Insurance Council of Australia Conference", Canberra, 9 August 2001*

### **Introduction**

Thank you for inviting me to speak at the Annual ICA Conference and for the opportunity to give you an update on some of the issues that are currently on ASIC's agenda, including several general insurance issues. It should become clear to you that ASIC's agenda is both very full and very diverse, and dealing with the wide range of issues before us is certainly a challenge. In such an environment, it is important we maintain an open dialogue with industry about what ASIC is doing and why, so I am pleased to be able to give you an overview of some of our activities and priorities today.

### **Insolvent trading and corporate governance**

Recent events surrounding the collapse of high profile companies such as HIH, One.Tel, and Harris Scarfe has brought "insolvent trading" and "corporate governance" back to the forefront of all our minds, including governments, regulators, industry participants and consumers. Whilst our investigations into HIH, One.Tel and Harris Scarfe are some of our more high profile investigations, we are also running significant civil penalty proceedings in Melbourne arising from the Waterwheel collapse; and in Perth three people were committed for trial in May this year on 46 charges relating to the failure of the Farmer Furniture group. Whilst these collapses are all the focus of the regulator's attention, it is important to acknowledge that the best governed of companies can still succumb to competitive and economic forces. In other words, whilst good governance does not necessarily assure corporate success...corporate failure does not *necessarily* imply poor standards of governance.

Whilst seeking to be on the front foot in preparing for stress points in the corporate sector, we also expect to meet the public's demands that ASIC be visible in enforcing the Corporations Law. As we have seen, when a company collapses, the perception amongst the public is that there has been a breach of the law. Whilst this may not always be the case, and the collapse may simply be a reflection of the times, increasingly significant collapses are referred to the corporate watchdog. I would like to note that this is not an attempt to move to regulation by "fear". Indeed, those who comply with the law have a vested interest in seeing that those who do not are visibly

brought to account. Clearly, people who play by the rules and are attempting to comply with the law will find us just as accessible and facilitative as we have been in the past. Nevertheless, we are an active regulator committed to strong enforcement action when required. We expect to deliver these outcomes without compromising ASIC's long-held commitment to due process, fairness and transparency.

### **Law reform and regulatory changes**

In the current environment of law reform, ASIC has undertaken a major exercise to consult with the financial services sector in relation to implementation of the Financial Services Reform legislation (FSR). During this consultation process, we have received comments from many industry groups in response to our policy proposal papers – the PPPs. We are in the process of considering all comments and are also awaiting release of the regulations as well as the Parliamentary Committee Report before releasing our final implementation policies. However, in light of the industry specific nature of these concerns and the necessity for different responses, we do not expect each and every industry group to agree with the stance that we have adopted. Having said that, we are committed to continuing our consultation role in a constructive and professional manner.

### **E-facilitation**

We are also focussed on developing an appropriate policy framework that not only facilitates business, but also enhances the level of consumer protection within the financial services sector. You may recall that two years ago at this conference I spoke about the online world and our forward-looking approach to policy development and industry communication in response to the challenges of e-commerce and cyberspace. At that conference, I mentioned that we would be releasing for consultation a policy proposal paper aimed at facilitating the use of electronic disclosure documents and application forms by life insurance companies and superannuation trustees.

I am pleased to say that that policy proposal paper was released for public discussion in October 2000, and on 31 May 2001 an information release was issued setting out details of how we will facilitate the use of electronic applications in the life insurance and superannuation industries. Given the pending reforms for the financial services industry under FSR, the relief described in the information release is an interim measure. ASIC intends to release a final policy in respect of electronic applications for life insurance and superannuation products after the pending financial services reforms are complete.

We have also been active in identifying new products or services – such as account aggregation – and conducting detailed surveillance on its use within industry. We have recently released for public comment our discussion paper on account aggregation, and look forward to receiving comments from industry about the regulatory issues that they perceive will arise in relation to this product.

### **Consumer Protection**

As the financial services regulator, we are constantly required to balance the needs of consumer and industry groups. As such, we expect our relatively new consumer protection role to continue to test our capacity to fulfil this role. Our structure now includes a national directorate of consumer protection, which is well equipped to deliver

on this part of our mandate. We have a number of priorities in this area that we will be actively addressing over the next few years. A key one is the further promotion of access by consumers to honest, competent and non-conflicted advice. ASIC will be seeking to ensure that conflicts of interest are clearly disclosed, that competency standards ensure appropriate advice is provided by properly qualified professionals, and that misleading conduct is dealt with effectively. FSR licensing requirements will be the vehicle through which we achieve some of these outcomes. We will also look to our misleading and deceptive conduct powers to deal with adviser problems if necessary.

## **Globalisation**

Globalisation yields challenges not only for the industry, but for the corporate regulator as well. Our HIH investigation provides an illustration of the impact of globalisation. As you are all aware, HIH belongs to an international conglomerate. This has meant that the Provisional Liquidator has had to deal with issues arising not only in Australia, but in the United States and the United Kingdom as well. As the corporate regulator, we have had to keep track of these issues.

Other examples of the impact of globalisation on our work is in relation to our regulatory oversight of the Australian Stock Exchange, as it continues to explore relationships with offshore markets; and as demands for cross border regulatory harmonisation grow louder in light of the emergence of dual listed company structures.

## **Disclosure**

Disclosure is an issue that lies at the heart of the FSR legislation. Disclosure issues are also very much in the public and Parliamentary arena at present. We are involved in active debates in areas as diverse as selective analyst briefings, mass-marketed tax schemes promotions and investment forecasts.

ASIC is committed to its ongoing campaign to ensure that companies comply with their continuous disclosure obligations under the Corporations Law and the ASX Listing Rules, and to protect investors and improve the quality of fundraising disclosure.

In February – July 2000, ASIC and ASX ran a two stage joint campaign in relation to the disclosure practices of listed technology companies, after which we released a list of "Top 10 Tips" for investors in dot coms. During this campaign, ASIC conducted surveillance visits of 20 listed "high tech" companies throughout Australia. As a result of our actions, 10 companies released additional information to the ASX either after being advised that ASIC would visit them or after the visit had taken place. Three of these companies released information only after negotiations with us and if disclosure had not been made voluntarily, we would have taken civil action to seek to compel disclosure. A number of issues were identified as a result of the campaign – for example, directors ignoring the basics of good company disclosure, directors not meeting regularly, proper accounting records not being kept, and basic financial records not being prepared – and these were referred to ASIC's account surveillance program for follow up. Just recently, two high-tech start ups – Min-Tech 8 Limited and CBD Online Limited – also provided further information to the market following action by ASIC and the ASX.

In May 2001, ASIC also undertook a surveillance project in relation to the disclosure practices of companies in quarterly cash flow statements. This project identified 18 high-tech listed companies, which had failed to disclose adequate information in their cash flow statements. Of these 18 companies, ASIC's action led to nine companies releasing additional information to the ASX. In relation to one other company, ASIC's enquiries led to the company appointing an administrator. I should note that ASIC is prepared to seek court orders where necessary in order to ensure that trading of securities takes place in an informed market. We are also prepared to take action to wind up companies in cases of insolvency. The FSR legislation will empower ASIC to seek civil penalties for market misconduct matters including breach of the continuous disclosure rules. ASIC is prepared to take action for contraventions of continuous disclosure requirements in appropriate cases.

As you may be aware, ASIC's "*Better Disclosure for Investors*" paper was released in August 2000. This paper suggests practical steps that companies can take to improve investor access to information and to promote better communication between listed companies and investors. The Australasian Investor Relations Association has just released more detailed guidance on communication between listed entities and the investment community. ASX is also currently preparing an update to its guidance note in relation to the operation of Listing Rule 3.1.

In light of the growing concerns that disclosure practices in fundraising documents were not what they should be, ASIC recently provided guidance to both preparers and reviewers of disclosure documents about the provision of forward looking financial information in such documents. It appears that too many prospectuses contain forward-looking financial information based on hypothetical assumptions. Our guidance paper now makes it much clearer that financial projections or forward-looking statements must be based on *reasonable* assumptions such as best estimates, and not on hypotheses. If they are based on the latter, they will be less likely to meet the required tests. We have placed, and will continue to place, interim and final stop orders on prospectuses that fail to disclose adequate information to potential investors – these are all public actions, so please visit our website if you wish to see the full range of the orders we have issued.

Finally on disclosure, I would note that ASIC is actively considering a range of possible responses to the issues outlined above that will aim to both improve the information available to consumers as well as clarifying the risks that both issuers and consumers bear in relation to information disclosure.

In dealing with all these issues, we look at the volume of complaints we receive, including from complaints schemes, we analyse industry and market trends and have regard to our dialogue with industry bodies and participants. We are seeking to be a regulator, which can identify risks and address industry issues before they become major problems. We do not want to be a regulator that simply investigates events after they have occurred, although we recognise that sometimes this is inevitable and must also be done. Effective risk identification and assessment is therefore a key focus for ASIC, and we believe that this approach will deliver better regulation and higher levels of consumer and industry confidence.

## General insurance issues

I will now turn to some more specific general insurance issues.

You will have heard Gary Potts speak earlier today about FSR, so I do not intend to go over the FSR policy issues in detail. Nonetheless, it is worth pointing out that ASIC has maintained an active dialogue with the general insurance sector over FSR implementation issues.

We have been pleased to receive feedback from the general insurance industry on ASIC's proposed policy approach to FSR requirements. I note, in particular, some key issues raised by the ICA and the general insurance sector:

- The ICA has highlighted its interest in the application of the "advice"/arranging provisions, in the context of the sale of a general insurance product. In particular, when can it be said that providing information over the phone in relation to a general insurance query could amount to the giving of advice or arranging a deal? We are aware of this concern.
- Related to the previous point is the broader question of what is "general" advice and what is "personal" advice? Without going into detail, we understand the industry's desire for greater certainty on these issues.
- I am sure you will all agree that IPS 146 has been a hot topic in industry discussions. I note in particular the feedback received from your industry in relation to whether more insurance products (eg, consumer credit insurance) should be added to tier 2 – the lower training standard?
- On the product disclosure statement disclosure requirements, we are aware that the ICA, like many other industries, seeks greater guidance in this area without too much prescription from the regulator. I am sure you can all appreciate that this is a very difficult balancing act! I am also aware that the issue of cooling-off periods is of great interest to the general insurance sector – let us just say we are expecting that the regulations may flesh out some of these issues.
- And, of course, we understand your interest in transitional arrangements.

I cannot leave FSR without making the point that ASIC's consultation with industry bodies has, not surprisingly, revealed inconsistencies in the approach that different industry groups take to issues such as disclosure and licensing guidance. Ironically, in some instances the groups with conflicting views may have common members. Some want less prescription, others want more so as to provide certainty. Some want core requirements introduced sooner, others want them later. One of ASIC's tasks, as an independent regulator, is to develop a balanced position on the approach to administering the various elements of FSR, taking into account the diversity of views we encounter.

## **Risk areas**

We also see a number of specific risk areas in the general insurance industry, as we do in most industry sectors.

### ***Sales practices to vulnerable consumers***

One is that we still see examples of poor sales practices at the more vulnerable end of the market. I am not singling out the general insurance industry on this point – this issue is not unique to this industry. But it is something that the regulator must be vigilant about, and it is also something that we take very seriously when the product in question is something that is as important to consumers as insurance. We will continue to highlight this issue to industry in order to ensure that it can focus on areas for improvement.

A major example since I last spoke to you concerns sales of insurance products in Aboriginal communities, in particular remote Aboriginal communities. Other examples include flood cover, and consumer credit insurance.

Over the last few years, ASIC has taken two major enforcement actions against companies for mis-selling insurance policies in these communities. Unfortunately, we are continuing to receive complaints about such conduct from several States and Territories.

The most recent example of major action by ASIC concerned the sale of general insurance accident and sickness policies. After a referral from a Fair Trading agency, ASIC's initial inquiries raised concerns that the insurance policies, which provided cover for accidental death or disability and for sickness, were not appropriate for many policyholders and that the conduct of the agents may have breached Part 2, Division 2 of the ASIC Act. For example, the policies covered consumers for accidents on forms of transport that are simply non-existent in remote communities.

ASIC obtained evidence that agents:

- Provided 15 – 20 minute presentations about the insurance to groups of between five and 30 people;
- Completed applications on behalf of individuals in 10 – 15 minutes;
- Made misleading and deceptive representations about the insurance, including that Community Development Employment Program members did not have workers' compensation or other cover;
- Did not explain to policyholders the terms, coverage, limitations or exclusions of the policies;
- Failed to provide copies of the policies to individuals to read prior to completing the applications, or failed to read the policy to individuals;
- In some cases, completed applications on behalf of individuals without their knowledge or consent; and

- Signed up children who were not eligible for cover under the insurance.

The policies were sold to policyholders in circumstances where:

- Most policyholders were covered by Workers' Compensation policies, which provided protection in the event of an accident;
- Most policyholders were eligible or entitled to benefits or cover in the event that they were ill or injured and unable to work; and
- Most policyholders were not financially sophisticated or experienced.

ASIC and the insurer negotiated a settlement which was in the form of Orders and an Enforceable Undertaking noted by the Court.

- The settlement provided, in summary that:
  - All Aboriginal policyholders be sent a notice that explained ASIC's proceedings and that community meetings and independent advice be provided;
  - Refunds of all premiums to those policyholders who opted to cancel their insurance;
  - A complaints mechanism be established to deal with complaints from Policyholders;
  - Independent consultants were appointed to review the company's compliance, marketing and training procedures; and
  - The insurer provided to ASIC funds to produce educative materials for indigenous consumers about insurance.

We are aware that at least 800 Aboriginal consumers who opted to cancel their insurance have been provided with refunds.

In highlighting this matter, I do not wish to suggest that sales misconduct in general insurance is widespread across the community. We find that most general insurance products are sold *without* generating concerns that come to ASIC's attention. However, I do believe it is important to highlight the fact that the problems that we *do* see often affect the most vulnerable consumers, and that they also are systemic in nature or involve difficult problems at the claims end of the business. For this reason, we will continue to target problem areas.

### ***Consumer education***

On a more positive note, I would like to highlight our consumer education initiatives. Just this week we have been finalising our consumer education strategy, which is to be released very soon. I should note that we received valuable feedback from the ICA on our education consultation paper, which we released last year for comment.

We have identified a range of initiatives that we expect will address both short-term needs and also start to make a bigger and longer-term impact on the financial literacy of Australian consumers. An example of the former is one that I have already noted – an education project designed to assist indigenous consumers better understand insurance products and their own insurance needs. Given the problems experienced with both life and general insurance sales over the last decade, this is an issue we would like to address up front. An example of the longer-term approach from ASIC is our plan to look at how we might improve financial literacy through the formal education system. I hasten to add that ASIC is only one player in this important area and our aims will have to be realistic, but we think that we need to start on addressing this vital issue. Our initial project will most likely involve a stocktake of relevant materials provided in schools. I am aware that the ICA has produced some material of this sort.

In this context, I would like to note that our consumer website, FIDO, has seen a massive increase in the number of visits over the last year – in the order of a 300% rise to 240,000 visits. You may be interested to know that FIDO now contains a separate section on "insurance". This site is further subdivided into sections on home insurance, car insurance, life insurance, and income protection insurance. The site provides consumers with practical guidance and useful information about how insurance works, how to go about choosing an insurance policy that meets their needs, how to minimise problems with claims and "quick tips" about insurance generally. I am pleased to say that this information has proven popular with consumers.

### *Insurance availability and problem risks*

The last matter I wish to highlight is a bigger picture issue that is not strictly within ASIC's jurisdiction. I am referring to the possibility of insurance risks that may not be covered. That is, will we see a growing class of consumers and businesses that may find it difficult to obtain insurance for an affordable price or indeed at all?

I do not want to be misunderstood as necessarily being critical of either the life or general insurance industries on this point. After all, the fallout from HIH has highlighted that in some areas risks were seemingly being underpriced. However, the obvious result of this is that we are seeing some highly public increases in premiums. The flow-on effect is a decision by some businesses or communities to no longer undertake the activities being insured. A widely discussed example is public liability coverage for rural shows, and I am sure you are aware of other examples. I know that there may be a range of reasons leading to repricing of risks and availability of cover, but as the issue of increasing premiums is the subject of an inquiry by the ACCC, I will not discuss these further.

What I would like to ask you to consider is the implications that may arise for your industry, and its regulation, if some businesses and consumers cannot access affordable insurance. We are seeing some of this first hand when we look at the question of the compensation requirements for licensees under FSR and current developments in the professional indemnity insurance market.

A challenge for this industry may therefore be to avoid the situation where it is perceived as an industry that is seen as failing to provide for the less well off, the less financially sophisticated, or those in difficult circumstances. In making this observation, I do not for a moment underestimate the task of combining strong

commercial outcomes for shareholders, maintaining strong prudential standards, and also maintaining a strong community image.

## **Conclusion**

In conclusion, it will be a challenging year for all of us. We will also face new challenges as we move forward under the FSR legislation, and as the regulatory landscape continues to evolve to meet developments in e-commerce, the demands of globalisation, and the consequent need for harmonisation in regulatory practices.

I am sure you will all agree that in this current environment of law reform, the need for constructive and thoughtful dialogue between all sectors of our community, including governments, regulators, industry participants and consumers, has never been more vital. With that in mind, I look forward to an ongoing interaction with the ICA and with you, the members.