ASIC

Australian Securities & Investments Commission

Regulatory update to general insurance industry 2016

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CHECK AGAINST DELIVERY

Introduction

Thank you to the Insurance Council of Australia for having me here today. I'd like to take this opportunity to talk about:

- recent regulatory and industry developments
- some industry lessons from ASIC's work over the past year, including in the areas of advertising, disclosure and the sale of inappropriate general insurance products, and
- a focus of ASIC's during 2016, general insurance add-on products.

In late October 2015, the Government released its response to the Financial System Inquiry (FSI) report. Among other things, the Government agreed to:

- create a principles-based product design and distribution obligation to make issuers and distributors more accountable for their financial product offerings. I'll talk about this proposal later in my speech
- provide product intervention powers to ASIC that could be used to modify products, or if necessary, ban harmful products in extreme cases
- include consideration of competition in ASIC's mandate, and
- support industry led initiatives to improve guidance (including tools and calculators) and disclosure for general insurance.

The FSI also recommended the introduction of an industry funding model for ASIC, in a similar manner to the model that APRA already operates under, and the Government is currently consulting on this model.

The FSI also agreed that there was scope to separate ASIC's registry business from its regulatory functions. The Government is currently examining options for the future of ASIC's registry business, including separation from ASIC.

All of these reforms have significant potential consequences for ASIC. Most require legislative change. And, of course, there is considerable consultation and policy development that will be required in all of these areas. We look forward to working with the general insurance industry as these reforms are rolled out.

International Association of Insurance Supervisors

Before moving on to talk about ASIC's recent work in general insurance I would like to note that last year, ASIC joined the International Association of Insurance Supervisors.

Why did we join? While the Association's objectives have traditionally focused on prudential supervision, they have now expanded into market conduct, and new standards are being developed in this area. It is, in effect, a sign of the times. Globally there is an increasing focus on market conduct risk and related business culture in all parts of the broad finance sector, including insurance.

This Association represents insurance regulators and supervisors of more than 200 jurisdictions, constituting 97% of the world's insurance premiums.

In January this year, ASIC was pleased to host the Market Conduct Working Group of the Association, of which we are a member, along with the Governance Working Group, of which APRA is a member. These meetings brought together regulators from around the world to continue to develop and improve the international regulation of insurance. It is important for Australia to have a role in influencing the direction of global standards.

ASIC's recent work on general insurance

I will now share with you some of the lessons from ASIC's recent work in general insurance.

The three broad themes I will focus on are:

- misleading advertising
- the sale of inappropriate products, and
- disclosure improvements.

Misleading advertising

It's in all of our interests to ensure that advertising and marketing is accurate and not misleading, which is why we retain a focus on this area. We continue to take action where we see examples of product features and price savings being misrepresented.

I'll provide two examples of misleading advertising in the past year where ASIC took action.

- An online advertisement for an airline branded travel insurance policy that represented that the policy covered loss arising from flight cancellation and changes, when in fact, the policy excluded cover for delays, cancellation and rescheduling.

  Consumers should be confident that they are getting the benefits advertised and for which they are paying.
- We were also concerned about the advertising of car insurance that promoted savings of an average of $357 off a new policy. However the savings claim was based on a comparison with the insurer's own product at the maximum level of excess, which the insurer knew most customers do not choose. In this case, the advertisement's disclaimer was not sufficiently prominent or clear to correct the representation that choosing that insurer or switching from another insurer would save the consumer money.

  Advertised savings must be reasonably achievable and properly and prominently explained.

Misleading advertising can prevent consumers from making the right choices about products that suit their needs. But more than that, it also can undermine competition in the market, by giving an unfair advantage and potentially additional market share to those who fail to comply. We want to see competition, but it must take place on a level playing field.

So ASIC will continue to monitor advertising. As I am sure you are aware, our Regulatory Guide 234[1] provides detailed guidance about the advertising of financial products.

Inappropriate products

In the past year, ASIC has also seen significant examples of consumer detriment in relation to the sale of inappropriate general insurance products.

In February, ASIC accepted a major court enforceable undertaking from an insurer whose authorised representatives were selling door-to-door sickness and accident policies. In many cases these policies were sold to consumers who were not eligible for cover. This included circumstances where the authorised representatives knew that the consumers needed coverage for particular activities and the activities were excluded under the policies. One example is where a representative attended a dirt-bike riding club and sold policies on the basis that they would cover medical costs arising from riding injuries. The insurer did not offer such cover.

[1] Regulatory Guide 234 *Advertising financial products and advice services including credit: Good practice guidance* (RG 234).

The authorised representatives also sold policies to consumers that duplicated coverage they already held and exceeded underwriting limits of the insurer. Consumers were encouraged to cancel existing policies and take up new policies that resulted in a change of coverage for no benefit and for some, significant detriment. The insurer has decided to run-off the business, agreed to implement a remediation plan to compensate affected consumers and make a contribution of $1 million to financial counselling and financial literacy activities.

In this instance, poor culture, weak compliance and conflicts of interest in remuneration clearly led to poor conduct, resulting in a financial cost to both consumers and the organisation alike.

Inappropriate sales have been a particular concern with so-called add-on products.

An example was the sale of consumer credit insurance to bank customers who did not have a home loan. The insurer in this case agreed to write to affected customers and offer them a refund of premiums paid for insurance cover they did not need.

As another example, last year, I referred to the Cash Store case that resulted in a penalty of almost $19 million, of which over $1 million related to the unconscionable sale of consumer credit insurance that was held to be inappropriate and unlikely to be of any use.

To update this matter, ASIC has since been able to obtain agreement by the insurers who issued that policy, to refund consumers a total of $2.4 million in insurance premiums and interest.

It is important that insurance products are *not* distributed in a way that results in sales to consumers who do not need or understand the product. At the extreme end, in too many cases recently we've seen policies sold to consumers, sometimes thousands of consumers, who are ineligible to claim under the policy. This is simply unacceptable.

It is also unacceptable for insurers to blame the distribution channel – advisers, brokers and authorised representatives. Frankly it reflects very poorly on the culture of any organisation who would seek to hide behind such an excuse. Those days are over. All parts of the industry have to accept responsibility for improving standards and consumer outcomes.

This was very clearly signalled in the FSI report, with the recommendation to create a targeted principles-based financial product design and distribution obligation. The Government has responded positively to this recommendation. While the creation of this obligation is subject to a consultation process, we anticipate that following its introduction, pre-sale consumer testing of new financial products by issuers will grow in importance as a part of financial product design.

As mentioned earlier, the Government, in its response to the FSI report, has also agreed to provide ASIC with product intervention powers to enable ASIC to modify products, or if necessary, ban harmful financial products where there is a risk of significant consumer detriment.

We look forward to working with industry on these reforms as they progress.

Disclosure improvements

I'll start my discussion of disclosure by highlighting some positive work by your industry. In early December, as you know, the Insurance Council released a report by the Effective Disclosure Taskforce on enhancing general insurance disclosure to better meet customer needs.

The Taskforce made recommendations aimed at making disclosure clearer, simpler and more effective.

I note that the report and next steps will be discussed in one of the breakout sessions later today, but some important recommendations to insurers include to:

- improve the provision of information to consumers about natural hazard risk
- work with ASIC and Government to improve the advice regime to enable disclosure of more targeted information to consumers, and
- integrate insurance calculators into the sales process to automatically help consumers select their sum insured.

Last year, insurers agreed to make a number of important improvements to their disclosure and guidance practices.

Improvements were made in the areas of credit card travel insurance, annual automatic car insurance renewals, and home insurance.

In the credit card travel insurance space, following our review of 17 brands, credit card issuers and insurers made a number of product disclosure improvements including clarifying:

- if and when cover is 'activated', particularly where a minimum spend threshold is required or reward points are used to pay for travel costs, and
- whether supplementary cardholders can benefit from the travel policy.

Another ASIC review involved six insurers who agreed to better inform consumers about automatic renewal when consumers first purchase their car insurance.

Insurers agreed to update their telephone sales scripts, along with clearer and more prominent disclosure on their websites and online sales screens.

While consumers may benefit from insurance that is automatically renewed, these improvements will help reduce the risk of consumers being caught by surprise by automatic renewals – sometimes finding they have paid for two policies for the same period.

Although this review targeted car insurance, we encourage similar point of sale improvements to be made for other types of insurances. This approach is similar to the recommendation of the ICA Effective Disclosure Taskforce that, 'The industry should shift from a minimum mandated disclosure approach to best practice transparency to better assist consumers to choose a product that meets their needs'.

ASIC has also undertaken a follow-up review to assess how industry responded to our Report 415 *Review of the sale of home insurance* (REP 415), to check on improvements in how insurers sell home insurance to consumers.

We are particularly interested in improvements to help consumers make the right choices when insuring an important asset – their home. We have looked into insurers' practices in the following areas:

- incorporating a sum insured calculator into the sales process
- training staff to help consumers understand that a sum insured amount should reflect the amount it would cost to rebuild or replace their home or contents, and
- training staff to help consumers understand that changes to building codes after a natural disaster can increase rebuilding costs after a total loss.

Our recommendations in this area have been echoed in the Effective Disclosure Taskforce Report's recommendations, and we welcome improvements made by industry. However, we consider that there is scope for insurers to take additional steps to provide guidance and advice to consumers. We do not think that the current advice regime prevents further meaningful improvements being made in the disclosure of more targeted information to consumers.

Add-on insurance in 2016

ASIC, like you, has a lot on its agenda for this year, and I'm not going to attempt to cover all areas. With the Government's response to the FSI report, and recommendations of the ICA's Effective Disclosure Taskforce, there is a lot of policy and industry reform underway. We expect that 2016 will be a year where we begin to see important actions being taken to give effect to various recommendations, which are key to helping consumers purchase good value insurance products that better meet their needs. It is also a period where we are increasingly focusing on the impact of new technologies on financial services.

Today, however, I'm going to highlight the work that ASIC is doing on add-on insurance.

I have mentioned add-on insurance in my last two speeches in this forum. To be blunt, progress in improving practices and standards in this area has not been good enough.

At times there appears to be an attitude regarding add-on insurance that 'it's not mainstream business, so we don't have to worry'. There has appeared to be an attitude that 'it's someone else's problem'. Our work, which is identifying systemically poor outcomes for consumers, is demonstrating that this attitude carries the risk of significant reputational damage. It's time to get your houses in order. We would prefer constructive solutions, but if ASIC has to take increasing amounts of enforcement action to remove the blind spot around mis-selling of these types of products then we will do so.

ASIC has just released two reports[2] about our work in this area focusing on the sale of insurance by car dealers. One report focuses on consumer experiences purchasing add-on insurance. The other is ASIC's review of the sale of life insurance sold though car dealers. This will now be followed by a review of general insurance sold via car dealers.

The consumer research found that many consumers who had purchased add-on insurance:

- had no awareness of these products, including their value, before they entered the car dealership
- were actively sold, and sometimes pressured to buy, the products
- could not recall which policies they had purchased, how much they cost and what they were covered for, and
- those that could recall the purchase, regretted their decision.

ASIC's review of sales practices found that life insurance issued in car dealers provides poor value for consumers and tends to involve high commission payments to the sellers – with upfront commissions of up to 50% of the premium being paid to sales people arranging business-use life insurance.

Business-use consumers can pay up to 80% more than regular consumers, for the same product.

A culture focusing on commissions and remuneration is a culture that emphasises sales and revenue over providing consumers with a product that meets their needs.

ASIC also found unreasonable price discrimination in this industry. Consumers can pay far more for life insurance sold to them through car dealers than if they were sold similar insurance through another distribution channel. And business consumers could be charged up to 80% more to obtain the exact same cover as a consumer with a personal loan for a car.

Low claims payouts relative to premiums was another important and concerning finding. Does this audience think that any alarm bells should ring about a product with a claims ratio of 6%?

Some improvements are starting to be made to address our findings, including insurers considering initiatives to provide better value to consumers, with more improvements expected. We will keep working with industry to continue to improve practices in this area.

It is important to note that in the course of our surveillances we have encountered troubling instances where insurers have been completely unaware of the insurance products that are being issued in their name. You may have thought earlier that I was using the phrase 'blind spot' about these products as a metaphor. We have found that for some insurers it's a literal description of senior management's understanding!

[2] Report 470 *Buying add-on insurance in car yards: Why it can be hard to say no* (REP 470) and Report 471 *The sale of life insurance through car dealers: Taking consumers for a ride* (REP 471).

This includes the Cash Store matter, but also more recently in our add-on insurance work. In some instances, senior executives within insurers have denied having anything to do with insurance sold through car dealers – despite Product Disclosure Statements naming them as the issuers of such products. Insurers cannot simply reach wholesale agreements with other insurers or underwriting agencies and ignore what happens next. As I said earlier, the days of washing your hands when it comes to the actions of distributors is over.

Our review to date has focused on the life insurance components of consumer credit insurance sold through car dealers, and we have now commenced a similar review of general insurance products sold as part of the purchase of a motor vehicle. So far, our review of general insurance add-on products suggests similar trends, such as dual pricing, with small businesses being charged significantly higher costs. Low claims rates also seem to be an issue. We are concerned that high commissions (as high as 70%) are a particular issue in general insurance as there is no legislative cap similar to the 20% cap for personal-use consumer credit insurance.

At a more general level, these issues go to the culture of financial firms. As ASIC's Chairman has spoken about recently, culture matters, in a very concrete way. It can be seen in remuneration and incentive structures, demonstrating a commitment to good consumer outcomes, and in approaches taken to claims and complaints handling and breach reporting. Importantly, a commitment to acting in the interests of your customers has to cover *all* of your customers, for *all* of your products.

ASIC looks forward to your industry's cooperation as our review progresses. But let me say, I do not want to be back here next year raising similar concerns about these types of add-on products. We have taken regulatory action, so if we have to focus on add-on products in this forum next year it is likely to involve a stronger focus on enforcement.

Closing remarks

In closing, I note that every year that I have presented at this forum, I have concluded that the previous year was a very busy year for industry and that the coming year will be similarly challenging. But the promise of change is on the horizon with industry and Government commitments that will improve market outcomes.

Having a good compliance culture that is consumer focused should help you to deal with these challenges greatly.

Thank you, again, for the opportunity to share ASIC's perspective with you today. We look forward to continuing to work with your industry this year.