



ASIC

Australian Securities & Investments Commission

Regulatory update to the general insurance industry

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CHECK AGAINST DELIVERY

Introduction

Thank you to Finity for inviting me to be here today. This sector is very important and I'm pleased to be able to talk to you about ASIC's work in the insurance space.

I have four main topics I would like to talk about today:

- the environment that we are currently in – and the opportunities that I think this provides for the general insurance industry
- what ASIC has been doing in insurance – and where we are going over the next year
- insurance comparison services and alternative approaches to help consumers compare insurance products
- in bringing together my previous comments, I would like to end by talking about the importance of having a good culture.

The current environment

Looking broadly across the life and general insurance sectors, it's clear that the current environment is one of increased public, media and government focus on insurance. I'd argue that this focus and scrutiny of the insurance sector – particularly life insurance – is broader and more intense than we've seen for many years.

Why has this situation emerged? In part, it reflects broader community concerns about culture, standards and conduct in financial services. Customer expectations have changed, and customers are more empowered than ever. We now live in a world with technology and social media at our fingertips.

And of course we have seen the conduct of financial institutions – including insurers – often adversely highlighted by the media.

Responding to these changing community expectations, the Government and regulators are looking at ways to raise standards and improve conduct. This is also apparent in the commencement of Parliamentary inquiries into both life insurance and general insurance. The latter is due to report next month.

Against this backdrop, we are in a significant time of industry reform and law reform. We are keen to work with all industry participants as we undertake our work in this sector, and as law reform initiatives are introduced.

On law reform, we are seeing the important recommendations of the Financial System Inquiry progress. Of particular relevance to your industry are the:

- product intervention power
- product governance obligation
- review of ASIC's enforcement regime, including penalties.

The Government has committed to accelerating the implementation of this law reform and I will talk about this more later.

In addition, ASIC has been working with Government and other regulators as part of the review of the Australian Consumer Law, particularly on the proposed extension of unfair contract term protections to insurance contracts.

The Government has also asked Treasury to consult on the recommendation made in our claims handling report that the exemption of insurance claims handling from the financial services conduct provisions of the Corporations Law be removed.

In the current environment, I think there is an opportunity for the industry to work with Government and regulators – as well as consumers – to bring about positive change; to make sure that consumers are getting the products that they need.

ASIC's recent insurance work and looking forward

Our current work

I will now talk about some of the work that ASIC has undertaken over the last year in insurance, which will continue to be a focus throughout 2017.

While I appreciate that this audience is primarily in the general insurance sector, I would like to start with a quick overview of ASIC's work on life insurance, as there are some lessons here that apply more broadly, and some common issues.

Life insurance overview

In the life insurance area, ASIC has recently reviewed, or will be reviewing, almost all of the key channels in this sector, as well as claims handling. This includes:

- ongoing work on the life insurance advice channel, which has led to major law reform with structural changes to remuneration and new industry data collection requirements
- a review of the direct insurance channel, which will consider the relationship between sales practices, product design and culture. We have found that insurance policies sold directly, with general or no advice, had higher rates of declined claims. That is one of the reasons why we have commenced a review of these direct sale policies
- a review of aspects of the way in which life insurance is provided through superannuation, including consumer communication and complaints handling. There is a need to improve disclosure about this offering, as well as claims handling practices and conflicts management
- significant ongoing work to follow up on our recent review of claims handling.

On claims handling, one of the key areas of work going forward is a joint project with APRA to significantly improve public reporting of life insurance claims data, claims outcomes, dispute levels, and claims and dispute handling timeframes across all policy types on an industry and individual insurer basis.

APRA and ASIC have been working on this initiative and [APRA recently released a public discussion paper](#) that outlines our approach to the work, our objectives and the process to be followed.

The regulators have planned iterative data collection and have issued data templates with definitions for key data items to life insurers. We will consider and consult on publication in Phase 2 to commence in early 2018.

I encourage you to read the discussion paper to learn more about this important work and to find out how to participate.

I reiterate that, while our focus in these projects is the life insurance sector, there are some clear lessons for the general insurance sector. Here are a few:

- Get your house in order, or the regulators, government, media and others will do it for you in ways that may be more onerous. A properly targeted review of the General Insurance Code is good start.
- Consider how you can improve the transparency around the outcomes you deliver to customers.

- Conflicts of interest in remuneration for managers and staff will, more often than not, lead to poor outcomes. Again and again we see that financial incentives matter; they drive behaviour – including the wrong sort of behaviour. As directors, what sort of line of sight do you have about how these are being managed?
- You can no longer wash your hands of responsibility for the products you sell and outcomes you produce just because a third party is involved in distribution or claims handling.
- Think hard about how you manage the difficult cases, the relatively small number of claims where you may be technically correct from a legal perspective but that fail badly on any reasonably public assessment of fairness.

If I were to summarise, it's not that complicated. It's about putting the customer first.

I'll now turn to some of the issues that ASIC is working on in the general insurance space, and I'd like to particularly focus on so-called add-on insurance.

Add-on insurance

ASIC has long had a focus on add-on insurance products, such as consumer credit insurance, as they have been a source of problems both in Australia and overseas. The payment protection insurance scandal in the United Kingdom, for example, has led to over £15 billion in compensation.

More recently, ASIC has had a particular focus on add-on insurance in the car dealership channel. Even if you are not in this market, there are some important findings that we believe apply more broadly.

Our review found that, over a period of three financial years (2013–2015):

- across five add-on insurance products, consumers only received nine cents in successful claims for every dollar paid in premiums. That is, there were \$144 million in claims against \$1.6 billion in premiums
- for consumer credit insurance, with \$507 million paid in premiums, the payout ratio was even lower, at just five cents in the dollar. In other words, junk insurance
- car dealers and brokers were paid over four times more in commissions than insureds received in successful claims (\$602 million in commissions against \$144 million in claims)
- there were instances where products were sold under single upfront premiums where it was impossible for the consumer to claim more than they had paid. This, it hardly needs saying, is not insurance.

These findings are not acceptable, and should not have been treated as acceptable or appropriate consumer outcomes by these insurers.

Insurers are now – in response to our review – engaging with this issue, and seeking to move away from those flawed business models. A number of insurers have agreed to significantly reduce premiums and improve loss ratios by voluntarily capping commissions at 20%.

ASIC is also working with some insurers to develop proper remediation programs for the consumer harm caused by past conduct. We expect that all insurers in this market will address the consequences of unfair practices in the design, sale and price of their conduct through such programs.

We welcome this engagement by insurers. Nevertheless our view is that there is a need for reform in this sector to ensure that improvements are comprehensive and permanent.

We will, therefore, be consulting on a package of reforms to add-on insurance with a discussion paper likely to be issued in June 2017. This will seek stakeholder comments on a range of options to deliver better outcomes.

One option that will be included is a deferred sales model. One of the issues we identified was the lack of competition in price and value of these products. We will, therefore, be seeking views on whether a deferred sales model can be used to further improve consumer outcomes through competition, and give the consumer the opportunity to compare different products. The full details of this option are still being developed internally.

Irrespective of the outcomes of this consultation process, we expect insurers to make changes to the design, distribution and value of add-on insurance as a matter of priority.

We have also chaired an industry working group that met earlier this year, made up of representatives from the industry and consumer groups. We set this up to develop a shared understanding of issues in the market. We are writing to insurers asking them to set out how they have made changes to add-on insurance design and distribution in line with the principles developed by the working group.

One of the other pieces of work we are undertaking is to seek regular data reporting from insurers about their add-on products. We are asking insurers to provide contract by contract information on both sales and claims.

A pilot request has been developed in consultation with insurers and the Insurance Council of Australia (ICA), and sent out recently to insurers for completion. The purpose of the request is to enable ASIC to:

- test the value of the products in a range of different ways, apart from loss ratios
- identify instances of mis-selling shortly after they occur. For example, we would be able to see if a representative sold cover up to \$30,000 on a \$10,000 loan, over-insuring the consumer, and then go to the insurer and expect them to address this conduct. This example illustrates the way in which ASIC is seeking to use data collection to enhance our broader regulatory role.

Finally, I'd like to make an observation about directors. While I have not met with the boards of directors of every insurer in this market, I have had an interesting response from those I have met. Inevitably they say 'we had no idea that we were selling a product with that sort of payout ratio'. Which leads me to ask, do you know the payout ratios of your products?

The year ahead: Culture and risk based surveillance

I would now like to touch on another aspect of ASIC's upcoming work.

As you may know, the Government announced last year an additional funding package for ASIC of \$121 million over four years – around half of which is for regulatory work in financial services. This will allow us to take more proactive steps to assess current industry issues.

Surveillance and investigation practices

One of the projects that will be undertaken with this funding is a review of surveillance and investigation processes used by insurers to identify fraudulent claims. This is an area that has been highlighted by consumer representatives and media who have raised concerns about processes which are detrimental to consumers.

Our review will commence in the second half of the year, and will focus primarily on general insurance, although we will include a sample of life insurance as well. While planning is in its early stages, we anticipate the review will include analysis of disputes received by the external dispute resolution schemes and consumer and legal advocates.

I'd emphasise that we recognise the need for all insurers to identify and appropriately deal with potentially fraudulent claims as part of overall claims management. Failure to manage fraudulent claims ultimately adds costs that are passed on to the vast majority of customers. But we want to make sure that, in investigating and assessing claims that seem at risk of being fraudulent, there is a balanced and sensible approach. And there are some interesting and important challenges here, such as the techniques used in cases where you are aware the customer has a mental illness.

Ultimately, this is also a question of culture. You need to manage claims, but how do you ensure that this doesn't step over the line into unfair treatment of customers?

Law reform

As I mentioned earlier, there are a number of key reforms underway that will have significant impacts for both industry and ASIC.

In December, the Government began consultation on the introduction of a new product design and distribution framework for financial products, and a product intervention power which will enable ASIC to take direct action to deal with significant shortcomings in products or conduct that result in consumer detriment.

Product design and distribution

The product design and distribution obligations will mean that issuers of financial products – including general insurers – will be obliged to:

- identify an appropriate target market for their products
- consider whether the product meets the needs of those individuals and is capable of being understood by them

- select distribution channels that are likely to deliver the products into the hands of individuals in the target market.

On the face of it, you might expect that this should not mean significant change for industry. These look to be sound principles that one would expect a well-run business, looking to treat their customers well, would follow.

And yet, our work on add-on insurance highlights the need for these obligations. Our findings put beyond any doubt that many of the disciplines that the new obligations will introduce are still needed – not just in one firm, but across the market.

Product design and distribution that puts good consumer outcomes front and centre should be at the heart of any insurer's business.

Product intervention power

This brings me to the product intervention power.

The new power envisages ASIC being able to take action on product features, the types of consumers who can access a product, and the circumstances in which they can do so. This would be warranted where significant consumer detriment has been identified.

In a world of effective design and distribution, there should be no need for such an intervention. But it does mean that, where other avenues have been exhausted and conduct that significantly damages consumers' interests persists, ASIC will be able to act more swiftly.

However, I want to make it clear to you all that ASIC is not waiting for these additional powers before acting to address problems that we see today.

Penalties

We have also recommended more significant penalties for misconduct relating to insurance claims handling, which will be reviewed as part of Government's review of ASIC's enforcement powers.

This will help strengthen the regulatory framework for claims handling, and improve ASIC's ability to take action where we identify concerning conduct.

The public expects nothing less.

I reiterate that we support the Government's proposal for law reform to make claims handling a financial service; we recognise the need to properly define this as a financial service and the obligations that should properly be attached to it.

Strengthening competition by improving product transparency and comparability

I mentioned the Senate Committee Inquiry into general insurance earlier. You may be aware that its terms of reference require it to examine the costs and benefits of a home, strata and car insurance comparison service.

We recognise the challenges of establishing such a service. I speak from experience, given that ASIC operates the North Queensland home insurance comparator comparison website.

In our submission to this inquiry suggested alternative options to help improve comparability and competition, such as reducing regulatory barriers to digital disclosure by insurers. Enabling providers to use technology to make disclosures in more engaging, informative and convenient ways. We have used our powers to remove those barriers where we can, and have called for legislative reform to remove those that we cannot.

We also recommended legislative changes to permit insurers to jointly develop and voluntarily adopt standardised policy terms and definitions. Standardisation would make it easier for consumers to compare different insurance policies with or without a comparison service. It would also help prevent consumers misunderstanding their policy cover – misunderstandings that our research shows is prevalent and that arises from the use of different policy wording by insurers.

Why culture matters

I want to comment finally today to you, that culture matters. At the centre of everything I have talked about today is a firm's culture.

Good culture is good for the bottom line and it is critical for firms that want to be around for the long term. Many studies have found that good culture is good for business and generating long-term shareholder value.

There are a number of ways that having a good culture can benefit your organisation, for example, by:

- increasing customer loyalty, brand and reputation
- reducing or avoiding the financial impact of fines or remediation
- attracting and retaining staff.

Poor culture, on the other hand, can lead to misconduct and result in significant financial costs, including the cost of remediation, compensation and fines; as well as not necessarily attracting and retaining high performing staff.

A culture that focuses on commissions and conflicted remuneration for intermediaries over and above providing consumers with a product that meets their needs is not sustainable.

A culture in which it is acceptable to simply pass a product on to a third party, with no consideration for who the final consumer might be and whether the product offers them any value at all, will inevitably lead to poor consumer outcomes.

Culture is a critical issue for directors.

Culture should also be at the forefront of the general insurance industry's mind as the ICA reviews the industry's code of practice this year.

We have made a submission to the review that discusses good culture further, and suggests a number of improvements to the code.

In our view, the code plays a central role in helping to raise the standards of the general insurance industry and instil consumer confidence in the products and services that the industry offers. The quality, scope and ambition of the code will determine the extent to which industry practice meets consumer needs and expectations.

The new code that emerges from this review must highlight the importance of good corporate culture. And it is relevant to reflect on an observation from the recent review of the Code of Banking Practice – namely, that the new code should be used by signatory firms as an opportunity to demonstrate and reinforce internal values and culture settings.

I hope our submission, and those of participants in the industry, assists the review to further strengthen the code.

ASIC has a broad discretion to approve industry codes of practice, though approval is not mandatory for the codes to operate. However, we hope that consideration is given to submitting the code to ASIC for approval, to act as a signal to consumers that this is a code in which they can have confidence.

Conclusion

I do hope this gives you a sense that the insurance market continues to be at the forefront of much of ASIC's regulatory agenda.

We hope to continue to work collaboratively with your industry to help ensure that consumers can have trust and confidence in the insurance industry.

Thank you.