ASIC

Australian Securities & Investments Commission

Regulatory update 2014: Insights from the Australian Securities and Investments Commission

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Speech to the Insurance Council of Australia (ICA)

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CHECK AGAINST DELIVERY

Introduction

Thank you for inviting me to speak to you today.

As always, I welcome the opportunity to set out ASIC’s priorities for the year ahead in the general insurance sector.

It’s a big year for all of us in financial services with the wide ranging Financial System Inquiry underway. I am sure the insurance industry is just as interested as ASIC to see the outcomes of this inquiry.

ASIC’s role

As you will be aware, ASIC is responsible for administering the provisions of the *Corporations Act 2001* (Corporations Act) which govern conduct and disclosure by financial services licensees. We are also responsible for enforcing the consumer protection provisions of the *Australian Securities and Investments Commission Act 2001* (ASIC Act) and for administering the *Insurance Contracts Act 1984* (Insurance Contracts Act).

Our aim in administering these laws is to ensure that consumers can have confidence in the financial system. Consumers should be able to trust the firms that they deal with and the information they receive. ASIC wants to see confident and informed consumers, and this objective determines the areas we focus our attention on.

In addition, ASIC is also concerned with ensuring that the market operates efficiently, and that we administer the law in a way that allows honest and competitive businesses to prosper. We want firms to operate on a level playing field where they understand the approach of the regulator.

Today I want to:

- run through recent reforms in the retail insurance sector, particularly those that emerged out of recent natural disasters
- outline several of our projects in the general insurance sector, including a review of home insurance and comparison websites
- set out ASIC’s approach to ‘add-on’ insurance products and why this is an important area of focus for the regulator.

Recent reforms

There have been a range of recent reforms to the laws that ASIC administers in the area of general insurance. These have had the aim of improving how the industry deals with consumers, in particular following the natural disasters of 2010–2011. These natural disasters highlighted areas where consumers were not necessarily well informed in their choice of financial product. Transparency and consistency in communication were both issues. This was a contributing factor to the introduction of a standard definition for 'flood'.

Reforms to the Insurance Contracts Act have included changes to allow insurers to use electronic communication to issue statutory notices and documents. Doing so will improve the speed with which insurers and consumers are able to share information, which should help improve outcomes not only for consumers, but also for insurers through increased efficiency and reduced costs.

Other changes included as part of the Insurance Contracts Act amendments give ASIC increased powers to take action to address breaches of the duty of utmost good faith by insurers, including in respect of claims handling. The duty of disclosure has also been made easier for consumers to understand and comply with, especially when renewing household or domestic insurance contracts.

Alongside these regulatory changes the general insurance industry has developed its own initiatives to address the needs of consumers in the wake of recent natural disasters, including through the introduction of websites focused on improving consumers' knowledge of insurance. These websites include the Insurance Council of Australia's (ICA) consumer website, 'understand insurance' and the Australian and New Zealand Institute of Insurance and Finance's (ANZIF) 'know risk' website. I commend the industry on these initiatives.

And while I'm talking websites I'd encourage you to have a look at ASIC's MoneySmart website, which has significant information about insurance – as well as many other financial matters – and which has more than 400,000 unique visits a month.

General Insurance Code of Practice

The commitment of the insurance industry to improve standards was also demonstrated by the decision to bring forward the review of the General Insurance Code of Practice (the Code). The recently concluded review was arguably the most comprehensive since the Code was first introduced, which is reflected in the revised Code released earlier this month by the ICA.

The revised Code includes new commitments and processes around claims and complaints handling, and offers consumers important options where they are experiencing financial difficulty. The decision to write the Code in plain English is also a welcome initiative and one that should improve accessibility for consumers.

We are conscious that the ICA has stated that it will consider seeking ASIC approval of the new Code. ASIC has provided regulatory guidance in relation to Code approval, in Regulatory Guide 183 *Approval of financial services sector codes of conduct* (RG 183), which covers matters relating both to the process of a code review as well as the content of a final code. While we have not received a formal application for approval, we have considered the principles set out in RG 183 as the review progressed, and are now considering the final content in that light.

NSW bushfires and underinsurance

While the revised Code better articulates the claims handling process, we have been pleased to learn that the insurance industry has already taken steps to improve the time taken to handle a claim. This has been shown in the data provided to us by the ICA about the recent NSW bushfires, particularly in cases involving total loss of residential homes.

Nonetheless, it seems that we continue to face challenges with underinsurance. We understand that claims arising from the NSW bushfires have highlighted a number of cases of underinsurance where consumers have found that, notwithstanding their claim being paid in full, they are unable to rebuild their homes.

The reasons for underinsurance from an insured's perspective are varied and I'm sure there are some here today that are better qualified to comment on individual cases. In ASIC's experience contributing factors to underinsurance include challenges that consumers face in properly understanding key aspects of their insurance, including:

- setting an appropriate sum insured
- effectively using online calculators to help estimate an appropriate sum insured
- affordability of insurance
- the effect of increased rebuilding costs during times of high demand following a natural disaster
- the effect of any changes in local building regulations due to bushfire and other natural disaster risk

We will continue to work with individual insurers, the ICA and Government to ensure that we reduce levels of underinsurance. We hope that our review of home insurance – and our subsequent report, which I will talk more about in a moment – will provide insights for the industry on some of the factors involved in underinsurance.

Home insurance review

I'd now like to discuss some of the projects and reviews ASIC is undertaking in the general insurance sector.

The first I'd like to cover is our current review of the sale of home insurance policies. The purpose of the review is for ASIC to better understand consumers' experience when purchasing home insurance policies and how this might be improved.

A common issue that emerged after the Queensland floods was the lack of consumer understanding about flood cover – as I mentioned earlier, there were concerns about the transparency and comprehensibility of cover. Many consumers were unaware that their home building and home contents insurance policy either failed to cover flood or limited the cover, or did not adequately cover all 'types' of flood damage, such as flash flooding. The aftermath of the recent bushfires in several parts of Australia has also highlighted concerns about consumers having a sufficiently high sum insured to enable them to rebuild. The issue of affordability is also relevant in this context.

ASIC has previously reviewed home building underinsurance in 2005 and 2007, in Report 54 *Getting home insurance right: A report on home building underinsurance* (REP 54) and Report 89 *Making home insurance better* (REP 89). REP 54 examined the causes of home building underinsurance after the Canberra bushfires in 2003. REP 89 examined what steps insurance companies subsequently took to tackle the causes of underinsurance after the first report.

The current review builds on that work, and also examines consumer experience when taking out home building insurance. To this end, we have sought information from industry about the sale and distribution of home insurance policies. We have also commissioned external consumer research into the sale of these policies to review consumer experiences in purchasing home building insurance.

Some themes which we plan to examine in the review include:

- the role of sales scripts at point of sale in providing transparent information and guidance to consumers when taking out insurance

- the use of calculators as a tool to assist consumers to set a sum insured
- how consumers can get readily accessible and consistent access to information about the policy through the sales process
- how issues of affordability affect consumer choice
- consumer behaviours and decision biases when purchasing home insurance
- the role of advertising in consumer decision making about insurance
- the relative importance of premium price compared to policy coverage and features.

While our review is still underway, we anticipate that findings will assist in identifying steps that might be taken to enhance consumers' understanding of policy coverage, to help them protect what is likely to be their most valuable asset especially in the event of a wide-scale natural disaster. We anticipate a report, including the consumer research findings, to be released mid-year. We will report our findings to Government, given the clear interest they have in this area.

Add-on insurance products

I'd now like to turn to some of our work that deals with so-called 'add-on' insurance products. A couple of examples include:

- consumer credit insurance sold with a loan
- various insurances sold with motor vehicles such as gap or tyre and rim.

These second tier products are not core products for all insurers, so why do we have a focus on this area? There are several reasons:

- Some of these products have been a perennial source of consumer complaints, including problems around mis-selling and claims.
- Add-on insurance appears in some cases to be extremely poor value to the consumer, with high profitability for the insurer.
- Selling practices associated with some products exploit consumer behavioural biases, including a tendency to overestimate the risk attached to what are often relatively small value losses. This is exacerbated by the fact that consumers do not self-identify a need for many of these products, and are often not familiar with them, which means that sales practices must be more aggressive, and that consumers rely to a greater extent on the statements made by sales representatives.
- Bundling insurance with other products affects the capacity of consumers to understand their costs, coverage and exclusions. In fact,

ASIC has found that at times consumers do not even realise they are purchasing such insurance when it is bundled up with other products.

Another reason for our focus on this area is that we've seen some recent and significant mis-selling scandals with add-on insurance in other jurisdictions. These overseas examples highlight just how badly things can go wrong.

Let me give a few examples:

- The payment protection insurance (PPI) scandal in the United Kingdom is a salutary lesson for anyone involved in the financial services industry. The new UK Financial Conduct Authority (FCA) has indicated that more than £13 billion in compensation has been provided to date, and the Financial Times stated earlier this month that almost £20 billion has now been set aside for claims. ASIC has invited Martin Wheatley, the new head of the FCA, to speak at our Annual Forum in March. One of his sessions will be a presentation on the lessons from PPI fiasco.
- Again from the United Kingdom, we have the current example of the CPP Group, who mis-sold, in conjunction with 13 banks and credit card companies, two add-on policies to cover the costs of having a credit card stolen or costs associated with identity theft. There are reportedly 7 million consumers eligible to claim reimbursement of the premiums plus interest, costing industry up to £1.3 billion. In addition CPP was fined £10.5 million by the FCA for its mis-selling of these products.
- In the United States, several of the most significant enforcement cases taken by the new US Consumer Financial Protection Bureau (CFPB) have involved add-on insurance products. For example, the CFPB announced in late December 2013 that it had ordered American Express to refund an estimated US$59.5 million to more than 335,000 consumers for illegal credit card practices, including the sale of add-on products.

Thankfully we have not seen problems in Australia on the scale of some of these recent events overseas. But ASIC, and the industry, should not be complacent. Our focus is to prevent these risks emerging – we do not want to be cleaning up a major mis-selling mess. And we have seen conduct in Australia in the not-too-distant past that has concerned us, for example in the area of consumer credit insurance, which if it became widespread could make the risk of a larger mis-selling problem very real.

We are closely examining the experience of the United Kingdom, the United States and other jurisdictions so that we learn the lessons to help ensure that we don't end up with mis-selling of this scale in Australia. This includes an examination of the products involved in these events, their features and their distribution. We will crack down on inappropriate conduct in this area with enforcement action if necessary, as we do not want to see these issues play out in the Australian market.

Consumer credit insurance

I'll turn now to some specific projects we have underway in relation to these add-on products.

In the area of consumer credit insurance we are reviewing the industry's claims handling procedures. We intend to release a report on our findings in the first half of this year.

Consumer credit insurance has been a source of problems in the past. For example, our examination a few years ago of consumer credit insurance sold with credit cards pointed to the risks of consumers not being made aware that they had purchased consumer credit insurance, or that it was optional. There was significant potential for consumers to be pressured and harassed by sales staff, including instances we found where consumers were being charged despite having clearly indicated they did not wish to purchase the insurance. In some cases sales staff continued to pressure the customer to purchase the insurance when the customer had already refused the offer two or three times. We also found relatively high rates of claims denied.

Our current review follows a research report we published last year about consumer experience with claims.[1] This consumer research report examined over 50 consumers' consumer credit insurance claims handling experiences. We have closely reviewed the findings of the consumer research and are incorporating issues and concerns raised in that review into our current work.

The research found that claims experiences are varied. Not surprisingly, the more informed a consumer is at the time of purchasing consumer credit insurance, the more likely they are to have a successful claims experience. To this extent we note that industry has already taken some significant steps to improve sales practices in relation to consumer credit insurance.

We will continue to work closely with industry to improve consumer experiences and outcomes in relation to consumer credit insurance.

[1] Report 361 *Consumer credit insurance policies: Consumers' claims experiences* (REP 361).

Add-on insurance sold through car yards

While on this topic, we have recently commenced a scoping study of 'add-on' insurance sold through caryards. This study will not only include consumer credit insurance but also other insurance products commonly sold through caryards, such as gap insurance, and tyre and rim insurance.

As you may know, ASIC recently took action in relation to tyre and rim insurance, which ultimately resulted in more than A$15 million being refunded to consumers. While our action was targeted at car finance intermediaries, it certainly raised the very real question as to whether there was adequate monitoring, supervision and controls on the insurances and other add-on products included with car finance packages.

Our scoping study has already identified a number of issues relevant to consumer credit insurance sold through caryards. These include:

- insurance purchased through a caryard is not the consumer's focus – it is a subsidiary decision after deciding on the car to purchase and which finance to obtain
- premiums are usually charged as a lump sum, and may be added to the loan amount
- loss ratios can be relatively low compared to other insurance products
- there are challenges for insurers in monitoring conduct because of the geographical diversity of their authorised representatives
- consumers have little opportunity to shop around to compare different insurance products on offer
- there are concerns with how conflicts of interest are managed.

Once we have finished our scoping study, we will make a decision on next steps or likely outputs.

Product Disclosure Statement reviews

ASIC also has a focus on disclosure as a key issue for consumers, and we conduct regular reviews of Product Disclosure Statements (PDSs) for different types of insurance cover. Our choice of product is influenced by reports of misconduct and breach reports received by ASIC, data received from the Financial Ombudsman Service on complaints, feedback from consumer groups and media coverage of problem areas.

Our current PDS review is focused on complimentary travel insurance which is provided with credit cards. While these policies are group policies purchased by the credit card issuer, we may contact specific insurers where we identify areas where they may need to make changes. As it is not the prime reason for the product purchase, there is a risk that consumers may not pay much attention to the cover until they make a claim, at which time it may be too late to deal with limitations or exclusions.

We intend to continue our regular reviews of PDSs to ensure that disclosure is in line with Corporations Act requirements and our guidance on disclosure.

Last year we reviewed pet insurance PDSs. This review resulted in us identifying areas where disclosure could be improved. We then worked with the relevant pet insurers and distributors, to improve disclosure in the PDSs and in promotional material. We understand that our findings have since resulted in important changes being made to many pet insurance PDSs. This is a very positive outcome and one we expect will improve consumer outcomes.

Advertising

I'd now like to turn to our work on advertising. Advertising of insurance products plays a significant role in advising consumers about the features of an insurance product. When advertising works well – when it is accurate and not misleading – it can help encourage competition and innovation. ASIC's aim is to make sure that advertising and marketing works to the benefit of consumers, as well as the benefit of compliant firms, by not being deceptive or false.

A challenge in the insurance sector is providing an accurate picture of the relationship between price and coverage in advertising and marketing. We have concerns that some insurance advertising disproportionately emphasises the price of the policy, rather than on other important features such as excess, benefits payable and terms and conditions. All of these features are required to give the consumer a full picture of the product and inform them about what is included in their policy.

Last year we took action in relation to Woolworths Comprehensive Car Insurance product, in response to an advertising campaign that focused on savings that consumers could realise by switching to their policy. We were concerned that the advertising campaign made a price comparison, despite potential differences between Woolworths' insurance product and the product consumers had switched from.

We were also concerned that the disclaimer used in the advertisement was not sufficiently prominent to effectively qualify the savings claim and was unlikely to correct any misleading impressions created by viewing the savings claim. In response to our concerns, Woolworths agreed to change the advertising campaign.

It is our view that the more qualifications that are required to balance the information contained in the headline claim, the clearer and more prominently placed the qualification should be. In some cases it may be that certain forms of advertising are simply not appropriate if qualifications cannot properly be explained.

To wrap up this topic, and acknowledging that they are not general insurance products, some of our concerns regarding the promotion of funeral insurance products may provide some illustration of the matters that will give rise to regulatory concerns.

As part of a recent review into these products we formed the view that some advertising of funeral insurance was not providing consumers with realistic expectations in relation to the cost and risks of the product. Relevantly, we were concerned that:

- premium increases were not adequately disclosed or explained
- qualifications relating to advertised prices were not sufficiently prominent
- quoted prices were not representative of the imagery used in the advertising, including the age of the actors.

We are pleased to see that changes have been made, both to advertising and the products themselves, but consider this is a sector in respect of which further work is warranted.

ASIC has taken a more proactive approach to the regulation of advertising in recent years across the financial services sector. We are actively reviewing insurance advertising and contacting individual insurers where we consider that the advertising is potentially misleading.

We encourage all insurers to adopt the good practice guidance set out in Regulatory Guide 234 *Advertising financial products and advice services (including credit): Good practice guidance* (RG 234). This guidance clearly sets out our expectations when it comes to advertising of financial products.

We will continue to review insurer advertising and take action where appropriate.

Closing remarks

As can be seen, this year will be a busy one for ASIC. It will also, I think, be a busy year for the insurance industry as you deal with increased focus from policy makers, regulators and consumers. Add to this the ongoing challenge of natural disasters – a challenge for all stakeholders.

ASIC certainly recognises the key role that insurers play in enabling consumers to manage important risks, and we look forward to working together to enhance consumer outcomes.

I thank you for the opportunity to present today.