



ASIC

Australian Securities & Investments Commission

Views from the Australian Securities and Investments Commission

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Introduction

Thank you for inviting me to speak to you today.

The Insurance Council's annual Regulatory Update is a great opportunity for the industry to get together and discuss current issues impacting insurers and their customers and to hear from the regulators about their priorities and areas of focus for the year ahead.

I'm pleased to be here to give you an ASIC perspective on the insurance industry.

The industry

All Australians benefit from a strong and responsive insurance industry.

Throughout its history, the insurance industry has been relied upon to provide insurance protection and security to the community. In Australia, that reliance has never been more important given the recent series of natural disasters.

In 2011 alone, we have seen bushfires in Western Australia, severe storms and flooding in Victoria, Cyclone Yasi, and of course, the devastating floods in Queensland. Current estimates put the cost of these disasters to insurers at nearly \$3 billion. Across the Tasman, we also now have the earthquake that struck Christchurch which will impact a number of Australian insurers. Over and above the human impact, it is going to be a very busy year for the insurance industry from a policy and regulatory perspective. One of the impacts of such disasters is that they put the insurance industry to the test, and draw out issues for examination, whether it be scope or understanding of cover, what happens when you contact your insurance company, the effectiveness of claims handling or the training and development of staff.

The Queensland floods have focussed attention on challenges such as unresolved issues around flood cover, disclosure and the application of unfair contract terms requirements for insurance. While these issues are primarily matters of policy, they signal a year where insurance is likely to receive a good deal more attention than perhaps has been the case in previous years. They also come on top of some existing regulatory reform which is relevant to the insurance industry, such as the Future of Financial Advice reforms.

At the same time, the insurance industry is changing and facing new challenges. We are seeing new entrants placing competitive pressures on existing players and also some pressure from insurance aggregators.

I am confident that industry can prosper by meeting these challenges, with innovative and responsive thinking and a commitment to the fair treatment of insurance consumers.

The role of regulation

As I am sure most of you are aware, ASIC is responsible for administering the provisions of the Corporations Act which govern conduct and disclosure by financial services licensees. We are also responsible for enforcing the consumer protection provisions of the ASIC Act and for administering the Insurance Contracts Act.

As the conduct and disclosure regulator, ASIC is not in the business of protecting existing players or of preserving the status quo. Competition is an important force in all financial markets. Competition encourages innovation, provides choice for consumers and puts pressure on prices and improves services.

ASIC's focus is on ensuring financial service providers meet their obligations to the market and to consumers and investors.

An important pillar of the regulatory framework is that financial service providers – including insurers – provide consumers with 'clear, concise and effective' disclosure. With better disclosure, comes more informed consumer decision-making which ultimately increases confidence in the industry.

As a regulator we strive to take a balanced and targeted approach in the general insurance sector.

We have a dedicated stakeholder team dealing with general insurance issues, and we have regular formal and informal liaison arrangements in place with the Insurance Council and individual insurers. This liaison is extremely important as it provides an accessible mechanism for industry to flag issues and to provide updates on what's happening in the market. It allows us to raise issues of concern directly with industry, seek feedback and exchange information on new proposals or market developments.

However, talking to industry is not the only way that we target our regulatory efforts in general insurance. We get intelligence through breach reports, complaints and enquiries made directly to ASIC, as well as through reports of systemic issues or misconduct from the Financial Ombudsman Service. We also get feedback directly from consumer representatives about the issues they see on the ground, and liaise with our fellow regulator, APRA, on a regular basis.

We actively review disclosure and other licensee compliance obligations to see if there are any problems requiring our attention.

Generally we think these liaison arrangements are working well. And through all of these various channels, we decide where and how to prioritise our regulatory resources.

In addition to compliance work, we are keen to continue to work with the industry on such issues as improving financial literacy, reducing under-insurance, and increasing consumer access to information and advice.

ASIC's areas of focus

So let's look at some of the current regulatory issues impacting your industry:

Flood cover

As I say, natural disasters have had an intense practical impact on the industry, as well as raising some potential law reform issues. In particular, the floods have thrown a spotlight on the issue of flood insurance.

This issue has been evolving for some time. ASIC published a report back in June 2000 on consumer understanding of flood insurance, following severe storms and flooding, particularly in Wollongong. This report is still available on ASIC's consumer website. Back then, we recommended that the standard use of key common terms should be explored and that the distinction between flood, storm and rainwater needed to be clear and consistent. A finding of that report was that there was scope for improved industry practices and better consumer understanding about flood insurance. We recognised that consumer education, sales processes and disclosure were key issues in improving consumers' access to cover for flood damage in home and contents insurance policies.

Since that time, a lot has changed, but listening to concerns being expressed by some stakeholders, it appears much is still the same.

In terms of what's changed, perhaps most significantly, the Financial Services Reform Act has greatly enhanced the regulation of general insurance in Australia and standards of disclosure have improved across the board, compared to where we were 10 years ago. Insurers are subject to a statutory requirement to present information contained in product disclosure statements in a "clear, concise and effective" manner. We are aware of a number of insurers that have worked hard to make their PDSs and policy wordings more user friendly. In terms of the cover too, flood insurance is now also more widely available to consumers than it was 10 years ago. And

with better tools, such as online calculators, and new products, like total replacement policies, the risk of underinsurance is being mitigated.

However, there are still some difficult and longstanding issues that consumer groups, the Government and the industry are variously keen to resolve and to increase transparency and clarity for consumers and industry alike. Among these are definitions used for flood, the need for more effective disclosure and better consumer understanding of their cover, issues for insurers in being able to price the risk of flood such as availability of flood mapping, and land-use planning. The Insurance Council's 10 point plan released in January addresses many of these issues, as does the plan released by a coalition of consumer groups around the same time.

Picking up on a couple of these issues, as you would be aware, the Government is working with industry to develop a standard definition of flood. Further, the Government and industry have agreed to develop simplified and enhanced disclosure by way of a one-page statement summary. Together, these proposals are designed to assist consumers to better understand how they are covered.

For ASIC's part, we will continue to look at current levels of disclosure on flood cover, and the promotion of flood cover, as well as other disclosure issues. As with all of these things, the devil is in the detail. From time to time we undertake selective reviews of general insurance PDSs for compliance with regulatory requirements. Such reviews include assessing the way in which particular PDSs disclose how the policy responds to flood damage.

We have attended some of the consumer forums on the flood issues held in Queensland. These meetings have demonstrated the level of concern held by some in the community around issues such as their understanding about whether they were covered for flood and what they are told when they contact their insurer.

We will continue to work with the industry, government and consumer groups on such issues as better disclosure, improving consumer financial literacy, reducing under-insurance, and increasing consumers' access to information and advice through shorter PDSs and policy summary pages. We acknowledge that more detailed flood mapping around Australia is integral to allowing the risk of flood to be fully understood and underwritten. This should help enable the development of a range of insurance products to supplement those already available.

We have sought to assist consumers to understand their rights and obligations in relation to holding insurance and making claims. Our consumer website, FIDO, has comprehensive information for consumers about buying home insurance, and we have recently updated it in response to

the floods and recent natural disasters to provide information for affected consumers. Increasing consumers' financial literacy is of key importance in tackling the issue of under-insurance and ensuring that consumers hold cover that is appropriate for their circumstances. Indeed, in our review after the Canberra bush fires, we recommended that industry consider offering complete or extended cover replacement policies along with more comprehensive building calculators to help minimise the risk of underinsurance.

In terms of a common flood definition, this is a matter on which the Government is actively engaging with the industry. ASIC has previously indicated that it is desirable for key definitions to be harmonised through the use of common terms. However, it is important to ensure that such definitions be of overall benefit to policy holders by enhancing clarity and consumer understanding, rather than restricting competition and consumer choice.

Competition in the industry – insurance aggregators

We understand that aggregators are increasing their activities in relation to comparing general insurance products, although they are not as widespread here as in the UK. We understand that there are some in the industry who are concerned that the widespread use of aggregators can lead to consumers choosing products based solely on price, and disregard other factors such as service or policy coverage. In many cases the true test of an insurance policy will be realised when a claim is made.

In the end, the market will determine what emphasis consumers place on the various factors involved in selecting their insurance product, and what will be the role of aggregators model.

For ASIC's part, as we have previously stated, we believe there could be a role for aggregators in assisting consumers to shop around and compare financial products. As I said, it is a matter for the market. However, we will take action, and we have taken action, where aggregators may be providing unlicensed financial product advice and/or engaging in misleading and deceptive conduct.

Moving onto some specific regulatory and surveillance activities in which ASIC has been involved that affect your industry, I will now talk about...

ASIC's regulatory and surveillance activities

Complaints handling – review of RG165

In February we issued updated regulatory guidance in RG 165 for financial services licensees to settle relatively simple disputes internally.

The update was in part in response to the concerns put to us by the insurance industry about the burden of responding in writing to customers for those complaints that can be resolved relatively quickly, but which may take more than one day to resolve satisfactorily. We were told that this would require written responses to tens of thousands of people each year, for sometimes relatively straightforward issues.

In listening to industry and consumer stakeholders concerns our policy intent was to introduce greater flexibility in settling simpler complaints by reducing paperwork obligations where complaints are resolved quickly at IDR. In the amended RG165 a final response will *not* be required where a complaint is resolved to the customer's complete satisfaction by the end of the fifth business day after the complaint is received. However, if the customer has requested a response in writing, then a final response in writing is required.

However, a final response is still required if the complaint is in relation to hardship, and, of relevance to your industry, a final response is still required for a declined insurance claim, or for a dispute on the value of an insurance claim. Following consultation with the industry and consumer groups, it became clear that these categories of complaints should be treated differently, given their seriousness and the significance of what is at stake for the consumer. We think this is a sensible compromise balancing the concerns of industry with the concerns of consumers.

For all complaints that are *not* resolved to the customer's complete satisfaction within five days, then they will continue to receive a written response, including EDR details. This preserves the crucial link between internal and external dispute resolution for more complex disputes. But licensees have greater flexibility to respond to complaints verbally, particularly where the complaint is relatively straightforward, involves small sums, or relates to a customer service issue that can be resolved quickly.

We expect licensees to comply with these new standards as soon as practicable.

On a related issue, which was flagged in ASIC's release of RG165, Insurance customers often phone their insurer to discuss a potential claim before lodging it. This issue came to light again during the Queensland floods. The risk is that policyholders with a legitimate claim might be

inadvertently dissuaded from lodging a claim. However, this needs to be balanced with the ability for policyholders to get information about their policy quickly over the phone.

The Insurance Council has agreed to consult with us and with consumer stakeholders on a proposal to amend the General Insurance Code of Practice to address this issue. The amendment would require insurers to ask customers verbally if they would like to lodge a formal claim in situations where customers make enquiries about whether they are covered for a particular event.

I understand the aim is to make the proposed change without waiting for the next formal review of the Code in 2013. We look forward to consulting with the Insurance Council further on this amendment.

ASIC's review of consumer credit insurance sales

In February last year we obtained information from 16 authorised deposit takers which actively sell and distribute consumer credit insurance with their credit cards, personal loans and home loans. This project followed compliance action taken by us in relation to the mis-selling of consumer credit insurance (CCI) and long-standing consumer concerns about consumer credit insurance. For example, in 2009, we raised concerns with one financial institution about their sales practices, after it came to light that in selling CCI in conjunction with credit cards, consumers were being sold CCI even where they had clearly said they did not want it. Also in 2009, we dealt with similar issues with another entity in relation to sales of life risk insurance.

Our review has therefore focussed on sales and distribution practices and the training and monitoring of staff who sell CCI products. We have made a series of findings, and we are finalising some best practice recommendations for industry.

We are currently finalising our report and will be meeting individually with the ADIs and other relevant stakeholders, including insurers, in order to seek their feedback on our findings and our draft recommendations. We will then finalise a public report (for release in the next few months). I believe that this will be a good example of ASIC and industry working cooperatively to improve outcomes for consumers and industry practice.

We are aware that the Financial Services Council is also concerned about these issues and we will be liaising with them, as well as the Insurance Council, as we take this work forward.

In conducting our review of sales and distribution, a number of other issues have come to our attention relating to CCI. We have noted that claim denial

rates for CCI tend to be significantly higher than for other insurance, cancellation rates are relatively high and payout ratios tend to be relatively low for some CCI products. We plan to look into these issues more closely in a second phase of the CCI review starting later in 2011.

ASIC's review of general insurance claims handling and internal dispute resolution

As many of you will be aware, in February 2010 we asked eight general insurers (representing 20 motor vehicle brands and we think at least 75% of the direct retail market) to participate in a broad industry review of claims handling and internal dispute resolution. The claim handling process is of course a very important time for policy holders as the intrinsic value of an insurance policy is in the ability to make a successful claim when a covered event occurs.

As part of this project we looked at motor vehicle insurance claims and IDR statistics for the 2009 calendar year, and details about internal guidance and policies about claims and IDR.

We had received consumer complaints which go to a lack of transparency in claims handling, lack of written reasons about excluded and denied claims, and multi-level IDR structures which have the effect of deterring complainants from pursuing complaints and accessing external dispute resolution. The project aimed to test these consumer concerns.

This review has provided us with a rich understanding of how general insurers manage their claims and IDR processes, and we are currently finalising our analysis, with preliminary findings and likely recommendations.

Our findings are likely to be viewed as generally positive for the industry. We were pleased to find that there is a high level of acceptance of motor vehicle insurance claims and the majority are dealt with efficiently. This is good news for the industry and for policy holders. The review has also identified a few specific issues we are likely to raise directly with some insurers.

For instance, our review found a relatively high level of "withdrawn" or "cancelled" claims across the motor vehicle insurance industry. We found different approaches are taken by insurers as to how withdrawn claims are communicated, and whether a withdrawn claim impacts on future premium assessments. We also found variability in the reporting and quality of information about declined claims.

In relation to internal dispute resolution, we found a prevalence of multi-tiered IDR procedures in general insurance. We found some insurers fast track complaints about denied claims which is probably best practice. We

also found variability in insurers providing written responses throughout the complaints handling process – hopefully from ASIC’s perspective any residual issues here have been clarified by the changes to RG 165.

We also note that, during the course of this review, some insurers have already made changes to their internal guidelines, standard letters and disclosure. This is an encouraging development.

We expect to provide a draft copy of our report to participating insurers and the Insurance Council shortly to get feedback on our findings and draft recommendations for best practice. We anticipate that we will then release a public report. Again, this is a good example of ASIC and the industry working cooperatively to tackle an issue. Hopefully, another benefit of our report will be that it will add to the quality of public debate on these issues.

We appreciate that this project involved quite significant work by insurers in providing relevant documentation, and we thank the participating insurers for that assistance during this project.

Proposed law reform initiatives

Moving onto more specific law reform initiatives of the Government that impact on your industry, I will now talk about...

Unfair contract terms

ASIC has a generally expanded role in relation to the new consumer law, including responsibility for unfair contract terms in financial contracts. As part of these reforms we also have new enforcement and consumer redress powers. For instance, one key area is in relation to mortgage early exit fees, where we have published regulatory guidance about how we think the unfair contracts laws apply for these fees.

The unfair contract terms provisions do not apply to insurance contracts governed by the *Insurance Contracts Act* by way of section 15 of that Act. As you would be aware, this has been the cause of significant stakeholder debate. In September 2009 a Senate Committee found that a case for excluding insurance had not been established and recommended that the Government reconsider its treatment of this sector. The Government issued an options paper in March last year, and sought comments on the proposed options.

The Government is also managing the proposed amendments to the *Insurance Contracts Act* which missed passage through the Senate before the Election last year, and may be reintroduced later this year. The amendments include provisions to allow greater use of electronic communications. If

legislated, ASIC would also obtain new powers, including being able to take representative action on behalf of an insured for a breach of the duty of utmost good faith, and licensing action for breaches of the duty in relation to claims handling.

These proposed reforms are policy matters for Government and it is not appropriate for me to express any view on the underlying merits of the policy. I note these issues because they are significant and topical issues for the industry at this time. Indeed on Monday of this week we, along with the Insurance Council and other stakeholders, attended a consultative discussion, chaired by the Parliamentary Secretary, the Honourable David Bradbury. We await further announcements.

Another current potentially significant area of law reform for the financial services industry as a whole is

The future of financial advice (FOFA)

ASIC has been assisting Treasury with its work on the proposed FoFA reforms, including attending consultation sessions with interested industry stakeholders. FoFA is the Government's response to the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into financial products and services in Australia. While proposed reforms are primarily aimed at the financial advice sector, they might have an impact across the financial services industry.

As you will be aware these proposed reforms include remuneration reform, including commissions and volume payments, and the requirement for clients to opt in to pay their adviser's fees each year. There is also a proposed reform which includes the introduction of a best interests duty for financial advisors, facilitating access to simple and limited advice, and simplifying Financial Services Guides. In relation to conduct and professionalism, an Expert Advisory Panel has been established to advise on Professional Standards and Ethics for financial advisers. This panel will provide views to ASIC on the competency requirements for financial services professionals, including training requirements, and how they should be tested or assessed.

At present the reforms are expected to be phased in from 1 July 2012.

Treasury has recognised that insurance has different features from investment products, including the fact that there are no investment funds which might be used to pay for advice. Treasury therefore wishes to explore concerns about affordability and the potential for under-insurance. In line with Treasury's intent to consider insurance issues separately to other financial products, Treasury met with the industry Peak Consultation Group, including the Insurance Council, on 24 January this year.

Further, part of the proposed FoFA reforms, Mr Richard St John was appointed to advise the Minister on the need for, and the costs and benefits of, a statutory compensation fund for retail investors. There are many issues to examine and Mr St John has held preliminary discussions with stakeholders, and it is expected that he will issue a public consultation paper and report to the Minister by June this year.

Any proposals for a statutory compensation scheme would obviously sit against the backdrop of the current compensation arrangements which are focused largely on professional indemnity insurance. In any case ASIC will continue to work with the industry to maximise the effectiveness of professional indemnity insurance as a compensation mechanism for the financial services industry.

Conclusion

In conclusion, I would like to thank you for the opportunity to present to you today. We look forward to continuing to work with the industry. This is a busy time for the industry and for ASIC, with the advent of recent natural disasters, ongoing regulatory surveillance projects and imminent law reform. As I said at the outset, all Australians benefit from a strong and responsive insurance industry.

That concludes the formal part of my presentation for today. I am now happy to take some questions from the floor.