



ASIC

Australian Securities & Investments Commission

Regulatory update to insurance industry

*A speech by Peter Kell, Deputy Chairman,
Australian Securities and Investments Commission*

*Insurance Council of Australia (ICA) 2015 Regulatory Update, Sydney
27 February 2015*

CHECK AGAINST DELIVERY

Introduction

Thank you to the ICA for inviting me to speak to you today. ASIC's relationship with the general insurance industry is very important, as your industry helps Australian households manage their risks on a daily basis.

Today, I'd like to talk about:

- recent work that ASIC has been undertaking and our focus over the coming year, including work on no-claims discount schemes, home insurance, the North Queensland home insurance website, and add-on insurance policies
- the Financial System Inquiry and the recommendations relevant to the general insurance industry, including around disclosure
- ASIC's recent consultation on facilitating electronic financial services disclosure, and
- the General Insurance Code of Practice.

Report into no-claims discount schemes

Yesterday ASIC released a report shedding light on the operation of no-claims discount (NCD) schemes for motor vehicle insurance policies.

We undertook a review of this area to:

- enhance ASIC's understanding of how these schemes operate
- identify any concerns regarding the operation, disclosure and consumer understanding of the schemes, and

- encourage insurers to address any inadequacies identified.

We asked 10 general insurers (representing 32 motor vehicle insurance brands) to participate in our review, and as detailed in the report, made a number of key findings for insurers to consider. I'll run through the key findings now.

We found that these schemes do not operate in the way consumers might reasonably expect. These schemes create an impression that claims history has been separated from other factors that determine the price of an insurance policy. We found that this is not the case in practice, and consumers may not understand the full impact a claim may have on their premium. For example:

- making a not-at-fault claim can have an effect on the underlying premium even where there is no effect on the NCD rating, and
- making an at-fault claim can have an effect on the underlying premium in addition to the NCD rating.

We found that in some instances the cost of purchasing ratings protection is higher than the benefit obtained by maintaining the NCD rating. Purchased 'ratings protection' is a feature offered by most brands that allows a policyholder to pay an amount of money to retain their NCD rating, even when making a claim that would otherwise affect their rating.

While the degree of disclosure of key elements of NCD schemes varied considerably between brands, it is generally inadequate, preventing consumers from being in a position to make fully informed decisions about purchasing or renewing a particular insurance policy or about making a claim. This is despite the fact that policyholders are regularly reminded of the value of attaining and maintaining a NCD rating - at point of sale, claim lodgement and/or renewal.

Our review also found that the majority of insurers apply minimum premiums, which have the potential to undermine and limit the full NCD entitlement. We found that the existence and application of minimum premiums is, in general, poorly disclosed.

Insurers generally position their NCD schemes as a reward for careful driving. However, we found that for most brands the majority of policyholders (between 90% and 99%) are on the highest NCD rating.

The concept of rewarding careful drivers is further challenged by brands that offer ratings protection, which has the capacity to reward drivers who claim, and results in partial subsidisation of these policyholders by other policyholders who do not make claims.

We understand that some insurers have shifted, or are in the process of shifting, away from the traditional NCD pricing model to a model where the assessment of claims history remains a stated factor in the calculation of the premium. The new models generally do not incorporate a ratings protection feature to prevent the subsidisation of drivers with a higher claims history.

We strongly encourage insurers who elect to retain the traditional NCD model to pay close attention to the findings and recommendations in the report. We will continue to

monitor this area closely to ensure that disclosure improves and that there is no misleading conduct.

Review of the sale of home building insurance

Another recent project for ASIC in the insurance area was ASIC's report into the sale of home building insurance, which was issued in October last year. This was the third in a series of reviews that we have undertaken which looked at issues around underinsurance.

This review was designed to:

- understand the information that consumers receive about home insurance at the *point of sale*, including identifying poor selling practices and gaps in consumer understanding and decision making, and
- identify opportunities to raise standards and encourage insurers to adopt practices that reduce the risk of consumers buying insurance that does not meet their needs.

Our review involved ASIC considering the sales practices of 12 insurers (representing 30 home insurance brands) who sell home insurance across Australia. We considered telephone sales, including reviewing 400 telephone sales call recordings, online sales, online calculators, advertising and promotional materials, and staff training and monitoring.

The review resulted in the release of two reports in October 2014:

- Report 415 *Review of the sale of home insurance* (REP 415), and
- Report 416 *Insuring your home: Consumers' experiences buying home insurance* (REP 416), which presented findings based on qualitative and quantitative research of consumers who inquired about or purchased home insurance during 2013.

Our reports make it clear that the home insurance industry can implement measures that will meaningfully improve consumers' understanding of their policy, and help ensure consumers buy a product that meets their needs.

These concerns were reflected in the Financial System Inquiry's final report, which was released in December 2014. I'll speak about the FSI's recommendations later in my speech.

Coming back to ASIC's review of sales practices; through this review we found that consumers need help from insurers to make better decisions, beyond simply receiving lengthy Product Disclosure Statements.

Our review of over 400 telephone recordings about home insurance found that consumers, not surprisingly, often asked questions and sought assistance from insurers about how best to estimate the sum insured. However most insurers have adopted a 'no advice' or 'factual information' business model which means they are unable to provide consumers with the information and/or advice they need.

Most consumers had to resort to ‘guessing’ the sum insured value, often using faulty assumptions to do so. This may expose consumers to over- or under-insurance.

Our review also found that consumers could have much better access to financial tools. Most insurers have tools, such as sum insured calculators, to assist consumers in estimating their sum insured. However, for telephone sales, our review found that most consumers were not referred to the available tools. This finding was compounded by the finding that consumers who paid the least attention when choosing the sum insured typically also believed that they were not at risk.

In our reports we recommended that insurers consider making calculators more accessible during the sales process to assist consumers in better estimating their sum insured value. We also point out that ‘no advice’ or ‘general advice’ business models do not prevent insurers from providing such assistance to consumers.

We also found that there is scope and a need to go beyond disclosure. We found that consumers need more help to understand the scope of their home insurance policies. Our reports found that the price of premiums dominated consumers’ reasons for inquiring and this focus limited the information they sought about policy terms.

We consider that there is additional scope to improve consumer understanding of the scope of the home insurance policy during the sales process. The Key Facts Sheets (KFS), which has been a requirement for home contents and home building insurance policies since 9 November last year, is a simple way of highlighting key insurance features, including important exclusions, caps and limits to consumers.

Our reports also highlight a number of other key practices that insurers should consider to help consumers better understand the insurance they are purchasing. In particular, while there has been significant progress by your industry in responding to the issues faced by consumers at risk in areas prone to natural disasters, there is scope for improving consumer understanding of these risks – for example, highlighting that consumers may need to be aware of council guidelines for rebuilding in disaster-prone areas, including the likely impact this may have on the cost of rebuilding.

We look forward to continuing to work with the industry to help improve consumer understanding of home insurance in order to improve outcomes for consumers, particularly in view of the heightened risk of natural disaster.

North Queensland home insurance website

On 23 October 2014, the Government announced the North Queensland home insurance comparison website. The Government’s stated aim in establishing this website is to help consumers compare home building and home contents insurance products on price and product features. ASIC was commissioned by the Government to establish this site by end-March 2015.

Since the Government's announcement, ASIC has been working closely with the ICA and its members participating in the North Queensland home insurance market to meet the Government's timetable for the establishment of the website.

ASIC has been very careful to ensure that the website content provides a balance of information across price and policy features. In other words it is important that the website contains both indicative price quotes and policy information to assist consumers in their search for the right home insurance cover for their circumstances.

When it is launched, the website will enable consumers to compare:

- building and contents policy features available from the insurers offering insurance in their particular locality in North Queensland, and
- indicative prices for building and contents cover for a range of sums insured and risk circumstances in their locality.

The website will include clear explanations about the nature, use and limitations of the comparisons displayed and prominent caveats for consumers using the website. Consumers will be warned not to solely rely on the comparison to make a decision about selecting home insurance and will be encouraged to contact relevant insurers directly about their specific circumstances before making a decision.

I would like to acknowledge the work that the ICA and participating members have undertaken on this project in their dealings with ASIC. We have been keen to achieve the widest possible representation of insurers offering insurance to consumers in North Queensland on the website, in a manner that is fair to all participating insurers.

We very much understand that there are challenges in bringing together all of the elements for such a site, and your feedback on the website has been useful. Having said this, the launch date is approaching rapidly. I therefore look forward to resolving any outstanding matters very quickly and working together to ensure a successful launch.

Add-on insurance

At this forum last year I announced that ASIC would be examining aspects of so-called 'add-on' insurance in various markets. These insurance policies have at times been a source of consumer problems both in Australia and other jurisdictions.

We have been looking at areas such as add-on insurance products sold with car loans, and travel insurance sold with credit cards, but before I discuss some of this work, I'd like to set out a recent court case concerning consumer credit insurance that highlights what can go wrong with these products.

Consumer credit insurance

Consumer credit insurance is of particular interest to ASIC. It has been the subject of court action since I presented at last year's conference. I refer you to the decision in *ASIC v The Cash Store Pty Ltd (in liquidation)* [2014] FCA 926 (the Cash Store case). In this

matter The Cash Store, a payday lender, sold a consumer credit insurance product that provided cover for the term of the payday loan only, for a period that could be as short as 1 day, and was typically only 13 days. Between July 2010 and May 2012 consumers paid over \$2.2 million in premiums, with only about \$25,000 paid out in claims.

Justice Davies found that [at paragraph 94 of the judgement]:

Sales of Consumer Credit Insurance by The Cash Store are characterised by moral obloquy and the opprobrium of unconscionability. The CCI was almost invariably inappropriate to offer to payday lending customers because it was very unlikely to be of any use to them. The terms of CCI were such that the insurance was self-evidently unsuited to needs of most customers and were most unlikely ever to confer a benefit.

This was an important and rare finding of systemic unconscionable conduct.

The penalties in this case, which also involved serious breaches of the responsible lending laws, amounted to almost \$19 million, of which the penalty for the insurance component was over \$1 million.

Clearly some products can be worse than others, but I commend this judgment to you as an indication of the matters ASIC will consider in deciding whether to take court action in relation to such policies. And I should note that ASIC is still examining the insurance elements of the Cash Store case.

Commissions and add-on Insurance

ASIC has conducted initial inquiries into the range of add-on insurance products being sold by car dealerships, and into the commercial relationships between insurers, lenders and car dealerships.

ASIC's scoping inquiries into add-on products sold through car dealerships have shown that commissions paid by insurers to car dealers can be very high – 50% of the premium or more.

The consumer typically pays the premium as a lump sum, so that the amount of the premium available to the insurer to meet claims is very low.

The value these products offer to your customers is therefore questionable in some circumstances. In ASIC's view these levels of commission create significant risks that insurers are selling products where either:

- there is minimal or no risk of a claim being made, or
- the amount the consumer may receive in the event of a claim is very low, either in dollar terms or relative to the amount of the premium.

ASIC has therefore decided to conduct a comprehensive review of this sector. This is being done through a survey of insurers seeking global data on matters such as premiums, claims rates and the nature and volume of commissions.

This data will enable ASIC to have a comprehensive understanding of the add-on insurance market, and the way in which insurers address the risks for consumers. We

think that once the analysis of the data provided through the survey is complete we will be meeting insurers with a view to exploring these issues in detail.

Advertising

This year ASIC will also retain its focus on advertising by the firms we regulate. Our Strategic Outlook for 2014-15 highlighted our concerns about innovation driven complexity and how the design and disclosure of retail products affects consumer decision making, behaviour and outcomes.

As we have said on previous occasions, ASIC considers advertising to be an important source of disclosure for consumers as it is often the first interaction that a consumer has with a particular product. Advertising can strongly influence a consumer's decision to purchase a product. However, when advertising or marketing material does not accurately describe a product, its key features and exclusions, it can be misleading. It can also create unrealistic expectations that lead to poor decisions, resulting in inappropriate products being purchased.

During ASIC's recent home insurance review we looked at the types of messages and information consumers receive about home insurance and found examples where advertising focused heavily on the price of home insurance premiums – that is, the headline claim focused on how much a consumer could save by switching to that particular insurer. Very little, or nothing, was disclosed about insurance features other than price.

Another recent example of where we have identified issues with advertising was a series of life insurance advertisements. The issues we identified are also relevant to the general insurance industry. Our concern was that the advertisements referred to both the maximum benefit of life cover available as well as the minimum premium payable, which created the impression that there was a link between the two statements. That is, it suggested that the consumer may be able to access the maximum benefit by paying the minimum premium.

Our view of such misleading impressions is that they cannot be easily qualified through the use of disclaimers.

Financial System Inquiry

I'll now turn to the Financial System Inquiry report.

The Government is currently consulting on the FSI recommendations until 31 March and any decision on whether to accept some or all of these recommendations will be made after this consultation process has ended and the Government has had a chance to consider all views. As part of this process ASIC is considering the report in detail and providing input to Government where appropriate.

I do not have time to cover all recommendations that might impact on either ASIC or your industry, but I'd like to highlight a few issues raised by the Inquiry.

Complementing ASIC's review of home building insurance sales practices, the FSI final report made recommendations around improved consumer guidance and disclosure for general insurance (including tools and calculators). This point was highlighted in relation to home insurance. They saw scope for industry to give better guidance to consumers on home building replacement value, and to ensure that tools and calculators are updated in accordance with relevant building code changes and cost information.

The FSI recommended that if industry doesn't make significant progress in this area, then Government should consider mandating the provision of guidance on replacement value.

The FSI also recommended removing regulatory impediments to innovative product disclosure and communication with consumers, and improving the way risks and fees are communicated to consumers.

I acknowledge that significant effort has already been made by industry to improve disclosure in the insurance space, and we trust that these efforts will continue and that consideration will be given to new modes of effective communication.

The FSI recognised the importance of current understanding about consumer behavioural biases in developing policy and regulation. It highlighted the importance for industry in taking notice of these learnings in designing and distributing products and in the ways it communicates with consumers.

The FSI also made recommendations around the introduction of a targeted and principles-based product design and distribution obligation. This recommendation is designed to ensure that products are designed with the end user in mind and are targeted accordingly. There is a clear message here that product manufacturers cannot simply wash their hands of actions taken by distributors.

The FSI raised particular concerns about add-on insurance products not meeting the needs of consumers, for example consumer credit insurance which was sold to consumers who were ineligible to claim under the policy.

Industry processes should promote the targeting of products to those consumers who would benefit from them, and reduce the incidence of consumers buying products that do not meet their needs.

The Inquiry recommended that the obligation be principles-based, leaving scope for industry to develop best practice for both the design and distribution of insurance products.

Electronic disclosure

As discussed earlier in my speech, ASIC sees a real need for improved disclosure for consumers. ASIC has worked over a number of years to reduce regulatory barriers to

digital disclosure. Our view, broadly, is that the use of technology to deliver disclosure, including in more innovative forms, can have benefits for both consumers and providers. Providers can use technology to present disclosure in ways that are more engaging and informative for consumers than traditional or printed disclosure documents, and deliver it to consumers in faster and more convenient ways. There may also be potential cost savings for providers in delivering disclosures electronically.

We hope that by making the regulatory environment genuinely technology neutral, we will enable providers to innovate and invest in better, more effective disclosure.

In November 2014, we released Consultation Paper 224 *Facilitating electronic financial services disclosures* (CP 224). We are consulting on our current guidance to make sure it has kept up to date with current technologies, and the growing familiarity with internet usage in Australia.

In the past, our guidance may have given the impression that there is an additional, more stringent requirement for the use of an email address for the delivery of disclosures compared with a postal address. We want to make it clear that this is not the case, and that an approach that differentiates between electronic addresses and postal addresses is no longer warranted.

A key proposal in CP 224 is to update our guidance to make it clear that, if a financial services provider has an email address for a client, they do not need special consent to use that address to deliver disclosures electronically, in the same way that the provision of a postal address is sufficient consent for the delivery of disclosures to that postal address.

We have also proposed to:

- provide an additional delivery option for providers to publish a disclosure document electronically, and notify the client that the disclosure is available online, and
- provide relief and guidance to overcome some remaining technical barriers to more innovative disclosure documents.

Submissions to CP 224 have now closed. We received a number of submissions, with a wide range of perspectives and we are working through these to develop our final guidance. In developing our final approach, we will look to ensure that we facilitate digital disclosure as far as possible, while still preserving choice for consumers to receive disclosure in the way that best suits them.

We do understand that general insurance has some special features, as it is also affected by the Insurance Contracts Act. We are still in the process of finalising our views on this front.

In December last year, we also announced a joint industry project to develop and test innovative approaches to disclosure in the investment space.

As part of this project, ASIC will work with two product issuers to develop and user-test a short, online 'key facts' sheet and a self-assessment tool to guide investor understanding. The providers may also present information in interactive or video form and offer other online tools for investors to assess their understanding of a product.

Of course, ASIC's work in this area is only one part of the issue. Industry also has a role to play in taking advantage of new digital technologies to develop innovative, engaging and informative disclosure.

General Insurance Code of Practice

I'd like to end my presentation today by talking about the General Insurance Code of Practice. ASIC continues to liaise closely with the ICA in relation to the industry potentially submitting a formal application for Code approval under ASIC's Regulatory Guide 183 *Approval of financial services sector codes of conduct* (RG 183).

We have undertaken a preliminary assessment of the Code against the requirements for approval as outlined in RG 183, and are pleased to confirm that we consider that the Code largely meets or exceeds many of the key criteria/requirements for approval as outlined in our guidance.

Importantly, the Code:

- is freestanding and written in plain language
- is a body of rules, rather than one single issue
- addresses stakeholder issues
- is adequately promoted
- allows for monitoring and enforcement of compliance, and
- is enforceable against subscribers.

The most recent review of the Code was, in ASIC's view, also an open, rigorous and comprehensive examination of relevant issues, with a high level of stakeholder engagement and transparency.

We have, and will continue to, engage in constructive discussions with the ICA in relation to these matters, and encourage the ICA to submit a formal application for Code approval.

That concludes my formal presentation, and I am happy to take some questions if time permits.