ASIC Regulatory Update: Expectations in the current environment? Our perspective on reform and regulatory developments

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CHECK AGAINST DELIVERY

Thank you for the opportunity to speak today.

I will talk to you about four broad topics:

- the **trust deficit in financial services** and what that means for standards of conduct in industry
- ASIC's focus on **life insurance** including ASIC's work on financial advice, direct insurance and insurance through super
- **opportunities for financial services firms** to strengthen codes and to take cross-industry action to restore consumer trust and confidence
- regulatory reforms with implications for both legal requirements and community expectations.

The current environment and the trust deficit

As ASIC Chair James Shipton said last week, the financial services industry is suffering a significant trust deficit in the eyes of the community. The industry was already subject to wide-ranging reviews *before* the announcement of the Royal Commission. That scrutiny has now significantly increased.

The Royal Commission is doing important work in highlighting the costs and consequences of financial services misconduct. Many of the instances of misconduct before the Commission so far have been the subject of ASIC investigations and/or regulatory outcomes, and the importance of addressing these concerns has been underlined by the Commission.

The Royal Commission is also highlighting the importance of community expectations and community standards. We have seen that an approach based on minimal or technical compliance with the law has, at times, been allowed to override fairness and good consumer outcomes. This will only undermine trust. The message is that the financial services industry needs to ensure that your conduct, and your products, take into account issues around community expectations and fairness. ASIC highlighted this issue in its review of life insurance claims handling in late 2016.

The community expects that the services you provide are beneficial, have value and are focused on good outcomes for the end user, including consumers and small businesses.

Challenges for industry: ASIC's recent focus on insurance and superannuation

I'd like to turn now to discuss ASIC's work in the life insurance space. Life insurance is a fundamentally important product for consumers, helping them to manage risks and deal with major financial stress. However, it is clear that in a variety of areas in the life insurance sector consumer expectations are not being met.

As a result, the sector is under an unprecedented scrutiny.

ASIC has been undertaking work across the three major channels for life insurance, as well as having a focus on claims handling.

In the advice channel, substantial legislative reforms to remuneration were introduced in January this year. These reforms were initiated following a review of life insurance advice by ASIC, which found that conflicts of interest in remuneration were impacting on the quality of advice.

We are now well into follow up work in this space. This includes the collection of data on higher lapse rates from insurers to help identify potentially higher risk advisers. We have already achieved several enforcement actions against advisers as a result of this work. ASIC is also tasked with a follow up review on the efficacy of the legislation in a few years.

In the direct insurance space, ASIC is well into a major review of sales practices and consumer outcomes. This was generated in part by our finding of higher claims denial rates in this channel. It is also an area where we had found some poor practices including pressure selling. We will report on our findings in the second half of this year.

We also have a focus on insurance in super. This is obviously an area of strong interest at present. In that area, ASIC has been looking further into the initial results we published last year in our Report 529 *Member experience of superannuation* (REP 529).

Insurance provided through super can provide substantial benefits to many members. But our findings also indicate areas where the consumer experience of insurance in superannuation needs to be improved. The issues we saw included:

- superannuation fund members not understanding that they have insurance cover, and not knowing they could claim
- making a claim, or understanding the claims process, can be difficult and time consuming
- retirement savings can be, at times, substantially eroded by insurance premiums.

Sitting above all of these channels is the issue of claims outcomes and claims handling. In 2016, we published Report 498 *Life insurance claims: An industry review* (REP 498) in 2016. Our findings in that report included:

- Around 90 per cent of claims are paid in the first instance. But there was still work to do.
- For TPD policies, some insurers had high rates of declined or withdrawn claims and that TPD represented a high proportion of all life insurance claims disputes in EDR
- We also found high lapse and decline rates for direct life insurance policies

Overall, we established the need for much more transparent, better quality and consistent data on claims outcomes. This is the subject of a major joint project by APRA and ASIC – the development of a public reporting framework for insurance claims outcomes.

The issues identified by ASIC and other stakeholders have already generated some important law reform, such as in the remuneration of life insurance advice. ASIC has also welcomed the Government’s announcement to look at further reforms, such as removing the exemption for claims handling from the consumer protection provisions of the corporations legislation.

Actions for industry

But it’s also important to ask – what can industry itself do to help improve outcomes? What steps can industry take to address some of these issues that are being highlighted by the regulator, by inquiries or by the community?

After all, within our regulatory system, the first line of ensuring compliance, and the fairness of financial services, rests with firms themselves.

One important point here is to note that there are two perspectives on improving interactions with customers:

- What can my individual firm do?

- What can my industry sector do?

In ASIC’s experience, a disproportionate amount of poor conduct and poor consumer outcomes arises because of the unfortunate and unproductive interaction between these two levels. In particular, we regularly confront the argument from financial service firms that, “I can’t change poor practices in my own firm, because everyone else in the industry is doing the same thing”. Poor conduct in your own business is apparently justified because “everyone else is doing it”.

Such an argument has always been a poor excuse, but it is clear that it is increasingly unacceptable to the community. One implication is that the importance of cross-industry initiatives will only increase. Firms will need to step up to ensure that not only their own standards, but industry-wide practices, are improved. I will briefly mention two examples of this.

Life Insurance Code of Practice

The Life Insurance Code of Practice, developed by the Financial Services Council, came into effect on 1 July 2017.

ASIC's direct life review has included a review of sales calls following the implementation of the Code, and we have observed some improved sales practices which appear to be as a result of the Code standards. This is an early positive sign. However, we have also identified areas for improvement.

The FSC is currently conducting a review of the Code, with early indications approval may be sought from ASIC, once it is updated.

The Code needs to be strengthened across a number of areas including: claims time frames, product design and distribution, assistance for vulnerable consumers, remuneration and bonuses, and reporting of serious breaches to ASIC.

We will continue to engage with the FSC through the course of the review to address these issues.

Insurance in Super Code of Practice

In a similar vein, the development and commencement of the Insurance in Super Code is an important step in recognising the need for industry to play a role in reform in this area. In particular:

- The Code was a first attempt at analysing premium caps to prevent benefit erosion – a significant event in relation to the issues with account balance erosion I referred to earlier.
- The Code introduced tighter timeframes of 45 days for dealing with claims and complaints, which should considerably improve the consumer experience of these processes.

- The Code also has the potential to introduce clearer and more consumer-focussed disclosure.

Nonetheless, the Code has significant limitations, such as its lack of enforceability and lengthy transition period into 2021.

Regulatory tools

There are two areas of regulatory reform which will play an important part in addressing the 'trust deficit', restoring consumer trust and confidence in financial services firms.

Design and distribution obligations and product intervention power

The Government when announcing its establishment committed to progressing previously foreshadowed reforms arising from the Financial System Inquiry.

This included product design and distribution obligations, or product governance obligations, on financial service participants, and the introduction of product intervention powers for ASIC.

The product governance obligations will apply to issuers or distributors, and would be imposed at the stage of product design and distribution, and after the sale of the product. Product issuers and distributors would be obliged to consider the type of consumer whose financial needs would be addressed by buying the product in question, and the channel best suited to distributing the product.

These obligations would bring accountability to issuers *and* distributors of products by requiring them to establish processes and controls for ensuring products are designed with consumer needs and understanding in mind, and are marketed to the section of the population for whom they are useful and appropriate.

There will no longer be the opportunity for 'product manufacturers' to point the finger at 'product sellers' and vice versa when something goes wrong, which has been an unfortunate feature of the financial services industry for too long. The reform signals that responsibility for good consumer outcomes lies right across the supply chain.

As a complement to these obligations, the Government has also consulted on a product intervention power for ASIC, that would enable us to intervene where a product is identified as creating a risk of significant consumer detriment.

The Government is still considering the scope of this power but ideally, this will be a broad flexible power that will enable ASIC to intervene in relation to all products within our jurisdiction, with a range of interventions including where features such as the remuneration structures are of concern to us.

With a flexible power ASIC would be able to take the least interventionist approach possible in the circumstances to achieve the right market outcomes. Banning a product outright may, in exceptional circumstances, be warranted, but the right PIP will enable a more graduated approach to regulation.

We encourage industry to start thinking now about whether your product design and distribution is meeting these obligations, and capable of producing good consumer outcomes.

Reform to IDR/EDR

As we all know, where products fail consumers, and things go wrong, it is important that processes that exist to deal with claims and disputes are as effective as possible, not least to minimise the impact on the consumer.

We see internal and external dispute resolution as an important part of the consumer experience of all financial products.

As part of reforms to IDR and EDR, in recent weeks we saw the Government authorise of the Australian Financial Complaints Authority as the sole external dispute resolution scheme.

In the super space, the Insurance in Super Code has set a 45-day timeframe for considering complaints, far below the current 90-day timeframe.

We are keen to see the steps industry will take to meet this standard.

One aspect of these reforms that has not received as much attention, is the planned mandatory collection and publication by ASIC of IDR data from all financial services licensees.

Mandatory, firm-level IDR reporting requirements are also set out in the AFCA legislation. This data collection will identify firms and will help improve transparency and accountability of firms' IDR practices.

The systems and processes around claims and disputes provides a rich set of data, from which organisations can learn where the issues are, and act to make changes to customer friction points: whether it's in product design, sales practices, or claims handling.

Financial services firms have the opportunity now to consider where they stand on meeting community expectations – do you have products and consumer outcomes that you can stand by? Or are you making products and systems, that make money more efficiently than achieving the purpose for which the consumer acquired it?

ASIC’s role

ASIC has an important role to play here, including:

- providing guidance to industry that is beneficial, clear, and supports industry to the best outcomes for members

- acting where we see industry participants engaging in misconduct, putting their own interests ahead of those of members, or failing to consider what is a good consumer outcome in any given instance.

There is also a role for ASIC to help consumers build their own financial capability, supported by community organisations, industry and the education sector.

Finally, financial services firms need to consider how you can positively engage with the challenge of meeting evolving consumer needs and community expectations.

I look forward to the participants in this room taking up the challenge.