

Insurance Council of Australia

Regulatory Update 2012

Insights from the Australian Securities and Investments Commission

Commissioner Peter Kell

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 discuss current regulatory issues impacting insurers and their customers, and to hear from regulators about their priorities and areas of focus for the year ahead.

The industry

Australians benefit from a strong and effective insurance industry.

The insurance industry has a history of being relied upon to provide insurance protection and security to the community. This reliance has been particularly important given of the high level of natural disasters over the last two years.

At the time of this Update last year, several devastating natural disasters had already occurred. A year later, we have seen that trend unfortunately continue, with severe storms in Victoria, Margaret River bushfires in Western Australia, Christmas Day storms in Melbourne, and flooding in Queensland and NSW. The industry has dealt with high levels of claims, and has paid, or will pay high claim amounts.

Of course there have been international events too, such as the Japanese tsunami and Christchurch earthquakes which have repercussions on reinsurance costs.

You will all be very aware of the focus on the insurance industry over the past year; for instance, there has been a Queensland Commission of Inquiry, and two Federal Government initiated Inquiries, as well as other government policy reform initiatives focusing on general insurance. These inquiries have highlighted government and community concerns about such issues as consumers' understanding of flood cover,

disclosure documents, the claims handling process, and how internal and external dispute resolution procedures operate.

The government has initiated some reforms to the regulation of general insurance, such as a common definition of flood, a key facts sheet for home building and contents policies, and is consulting on other proposals arising from the Natural Disaster Insurance Review, and other initiatives. Some changes are also mooted for the General Insurance Code of Practice.

While we continue to consult with Treasury, industry and other stakeholders as required on these various initiatives, today I will focus on some issues of particular interest to ASIC.

We recognise that this is a busy time for the industry, with the various regulatory reforms initiated by Government on top of the usual commercial pressures. We are confident that the industry can meet any challenges this may represent, with an innovative and responsive approach, and a commitment to the fair treatment of consumers.

ASIC's role

Most of you will be well aware of ASIC's role in 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*.

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

ASIC contributes to Australia's economic reputation and wellbeing by following our strategic priorities, which are to ensure confident and informed investors and financial consumers, fair and efficient financial markets, and efficient registration and licensing. The priority that is probably most relevant to your industry is 'confident and informed investors and financial consumers'.

We are currently focused on holding gatekeepers to account, and these include auditors, directors, advisers, product manufacturers and distributors. Our role in ensuring fair and efficient financial markets through our role in market supervision

and competition, and ensuring good corporate governance, is also of relevance to your industry.

ASIC's engagement with industry and other stakeholders is key to assisting us to achieve our priorities, and we value our relationship with the general insurance industry, and the opportunity to meet regularly to discuss topical issues. Our dedicated stakeholder team dealing with general insurance issues primarily manages this liaison. It allows us to raise issues of concern directly with industry, to seek feedback, and to exchange information on new proposals or market developments.

In addition to liaising with industry, we target our regulatory efforts in general insurance by obtaining 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 obtain feedback directly from consumer and industry representatives; and we liaise with our fellow regulator APRA on a regular basis.

We also actively review disclosure and other licensee obligations to identify if there are any issues that require our attention. Through all of these channels we decide how to prioritise our regulatory resources.

Generally we think that these liaison arrangements are working well, and they assist us to take a response and balanced approach.

In addition to compliance work, we are keen to continue to work with the industry on issues such as improving financial literacy, reducing underinsurance and increasing consumer access to information and advice. The recent ANZ Survey of Adult Financial Literacy indicates that, while consumers have an increased understanding of cooling off periods, there is still progress to be made in terms of reducing underinsurance, consumer understanding of the duty of disclosure, and the need to regularly review levels of cover.

ASIC's areas of focus

So what does this mean for the general insurance industry in the year ahead? Today I will cover two main current regulatory themes of relevance to general

insurance: firstly, consumer information both through advertising and disclosure; and secondly, claims handling and the related process of internal dispute resolution. I will now talk briefly about our recent and anticipated work in these areas.

Advertising and Disclosure

As I have mentioned, ASIC seeks to promote confident and informed financial consumers. This includes recognising how they make decisions in real life, and ensuring that communications about financial products facilitate effective decision-making. An important part of this is acknowledging the role that disclosure and advertising plays in this process.

At a time when consumers are making more financial decisions than ever before, the environment in which they are making those decisions is becoming increasingly complex. We know that advertisements are an important source of information to consumers. They are also an important way for promoters to raise awareness of their financial products and services in the market, and thereby generate competition.

Advertising therefore holds many potential benefits for both industry and consumers. However, if these benefits are to materialize, promoters must give clear, accurate and balanced messages when promoting financial products.

Last week we released Regulatory Guide 234 *Advertising financial products and advice services: Good practice guidance*, setting out good practice guidance to help promoters comply with their legal obligations to not make false or misleading statements, or engage in misleading or deceptive conduct.

This guide follows an extensive consultation process, involving a formal consultation paper with feedback through written submissions as well as meetings with stakeholders (including the insurance industry) to discuss their concerns with our proposals.

Where appropriate, we revised the proposals in the consultation paper to take this feedback into account. We are grateful for the many useful submissions that were made.

A key focus of our consultation was on the need for our guidance to be neutral as to the type of media used for advertising. This can present challenges for internet advertising, which may be relatively brief and therefore constrained in the amount of information it includes. Promoters should consider the overall impression created by the advertisement when viewed by itself for the first time. For example, the stronger a headline claim in an advertisement, the more important it is for any risk information to be included in the advertisement itself and not included in a reference to another page where the consumer can find out information about the risks.

We regularly review advertising, including internet advertising, and we contact specific insurers with any identified issues. Since July 2010, ASIC's actions have resulted in 117 advertisements across the financial services sector being withdrawn or remedied in response to concerns about poor practices and potentially misleading or deceptive conduct.

The outcomes we will aim for when confronted with suspected breaches will involve potentially stronger penalties than we have sought in the past. Powers at our disposal include issuing stop orders and public warning notices, and seeking civil pecuniary penalties.

Some areas that we have identified in the past of particular relevance to insurers are:

- the need to ensure that comparative advertising compares "like with like";
- ensuring that any special conditions on promotional offers are disclosed in a sufficiently prominent manner in the main text of the advertisement;
- ensuring that any qualifications to headline claims are clearly disclosed in the advertisement.

We have consulted with the Insurance Council when we identified general issues with advertising that we considered were beneficial to discuss with the industry as a whole. We encourage the Insurance Council, or individual insurers to discuss any such generic or specific issues with us.

One of the points we consulted on in our advertising consultation paper is the need for advertising to be consistent with product disclosure statements, which of course

are also an important source of information in a consumer's financial decision-making process. Inconsistency between the information presented in an advertisement, and in a PDS may reduce a consumer's ability to fully understand the features of the product. And that leads me now to the topic of product disclosure statements.

Product disclosure statements

The challenge for insurers is to observe the requirement for the PDS to be "clear, concise and effective", whilst appropriately disclosing all relevant aspects of the policy terms.

Many insurers will be in the process of reviewing PDSs if they are considering altering their flood cover, or for other reasons, and we encourage insurers to continuously seek to improve the clarity and accessibility of PDSs for consumers. In this context claims handling and dispute resolution experience can be an informative source of feedback on how well PDS communication has worked and on how it might be improved.

The Queensland floods and other recent natural disasters have drawn attention to the issue that many consumers do not tend to read PDSs until the time that they make a claim. This is not a new issue, and it is not unique to the general insurance sector, but we all need to continue to work on improving the readability and accessibility of these documents. The Government is reviewing this issue, and proposes a short key facts sheet setting out the key aspects of the policy. After all, the PDS remains an important document, containing the full policy terms.

As you know, the Government also proposes to introduce a common definition of "flood" for home building and contents policies, strata title properties and small business properties. This should assist with comparability and consumer understanding of policy coverage, but again, it remains critical for insurers to strive for clear and effective disclosure across all insurance lines.

We regularly monitor PDSs, and will raise any concerns that we identify with insurers. We are particularly concerned where a significant limitation on cover is not clearly disclosed, or where the disclosure is at odds with the actual cover offered.

Telephone sales

A related challenge to disclosure arises in the real world manner in which insurance policies are commonly sold and how consumers like to shop for insurance: via the telephone. Whilst convenient, this medium raises challenges for disclosing key information at the point of sale, particularly where there are significant limits on cover. While they would be disclosed in the product disclosure statement, such limits are not necessarily dealt with in the telephone sale conversation. There is a cooling off period, but many consumers do not take the time to read the PDS when they receive it, or to utilise the cooling off period. The telephone sale discussion therefore is critical to a consumer's understanding of the policy purchased, or to assist consumers to compare policies.

The use of telephone scripts is important to ensure that staff do not provide information or advice that is unauthorised, incomplete, inaccurate or misleading. For instance, in our review of sales practices by ADIs of consumer credit insurance, we recommended that formal phone scripts include a clear explanation of the main exclusions that apply to the CCI policy.

Last year we also considered the issue of providing premium quotes over the telephone to consumers shopping around for quotes, and the practical difficulties of giving a PDS during such a phone call. The *Corporations Act* requires a PDS be given at the time that an offer is made to acquire a financial product. We found that there had been issues with compliance with this requirement where a "final" quote is provided which constitutes an offer to issue the product.

We consulted extensively on the issue, and how it should be resolved, and we issued Class Order conditional relief to modify the requirement to give a PDS. This gives the industry greater certainty about providing quotes over the telephone, while providing the consumer with the option to receive a PDS after the quote is given.

In doing so, we sought to balance the consumer protection goal of providing a PDS, with industry concern about compliance costs, and recognising the importance to consumers of shopping around for insurance quotes over the telephone.

Aggregators and comparison websites

As part of the work that we do in monitoring advertising and other disclosure, we review comparison websites to ensure that they hold an Australian financial services licence if they are providing a financial service.

We recognise that where they provide clear, accurate and unconflicted information, comparison websites can facilitate competition and assist consumer choice. The recent ANZ Survey of Adult Financial Literacy found that 36% of people compare insurance using online sites; and 64% of consumers shop around for home or car insurance. Given consumers' increasing reliance on these websites to "shop around" for financial products and services, it is especially important that comparison websites comply with their legal obligations not to make false or misleading statements, or engage in misleading or deceptive conduct.

We also have concerns where such websites inadequately manage conflicts of interest, for instance, if there is a relationship between a particular insurer and the website, and this is not adequately disclosed to consumers. We also review the basis for any awards or ratings for certain products by the site; and how the website discloses any links to the providers of the products, including the payment of commissions and other payments.

We consider that the basis upon which products are compared should be clearly disclosed, especially where the full range of available products are not included in the comparison.

ASIC is considering a separate review of industry practices in the comparison site sector across financial services in the near future. This would include looking at whether there are issues of quality, disclosure and conflicts of interest in research and comparison services for comparison websites including general insurance, banking and consumer credit products.

Consumer credit insurance

Closely linked to disclosure, in October last year we issued a report on consumer credit insurance sales practices by authorised deposit taking institutions (ADIs). Our

report focused on sales and distribution practices, and also reviewed sales and claim volumes, training and monitoring systems, and complaints and breaches.

There were some longstanding concerns about the sales processes for CCI, and we had received complaints, and conducted investigations that indicated that there were some persistent issues with the sale and distribution of some CCI products.

In 2009 we investigated complaints in relation to particular concerns about sales of CCI, including the use of pressure tactics and harassment, misleading representations, serious deficiencies in the scripts used, and consumers being sold CCI policies without their knowledge or consent – where, for example, CCI is bundled into a credit card activation process.

We were also concerned about the denial rates for CCI: 13%, compared to 2% for all personal general insurance claims. The net loss ratio is also relatively low: 34% in 2010.

In our review, we identified some significant deficiencies in the practices used by ADIs to sell CCI that may lead to CCI being mis-sold or consumers not adequately understanding the products they are purchasing. We found issues with inconsistent use of phone scripts, consumer awareness about making a CCI purchase, consumer consent to purchase CCI, consumer eligibility for CCI claims, pressure or harassment by sales staff, consumer understanding of the cost of CCI, and consumer understanding of the duration of a CCI policy.

In relation to disclosure, we identified issues with the timing of providing a PDS, and ongoing disclosure. We also identified issues with training programs used by ADIs to train their staff, monitoring systems, and complaints and breaches.

In order to address our concerns, we made a series of recommendations. Having considered procedures and practices across the industry, as well as outcomes for consumers, we think these recommendations reflect best practice and will help ensure confident and informed consumers.

Our recommendations include using formal sales scripts when selling CCI over the telephone; obtaining adequate evidence of consent to purchase CCI; disclosure of interest payments on CCI premiums; provision of separate quotes for CCI and the

underlying credit contract; disclosure of the premium structure; disclosure of duration of the CCI policy. We also suggested that it is important to ensure that the PDS is provided at the appropriate time; and that consumers are provided with ongoing information about their CCI policy. We recommended ensuring staff have ongoing training; and having documented monitoring systems in place to detect non-compliant sales of CCI. We are encouraged that industry, through both participating ADIs and relevant industry associations including the ICA, has acknowledged the significance of the issues we identified and accepted our recommendations.

We propose to follow up our 2011 review of CCI with a review of specific issues we identified around claims and complaints handling which warranted further examination. From the data that we obtained from the 15 ADIs we reviewed, we found a denial rate of 15.9%, with one ADI having a denial rate of 46.9% (for CCI sold with credit cards), and seven of the ADIs reviewed having denial rates of 30% or more for CCI sold with one or more products they distribute. Indeed CCI has the highest decline rate of any general insurance product. This together with the significant variation in the number of complaints reported, and the low number of breaches recorded by ADIs raises questions about how claims and complaints about CCI are handled and recorded, why so many claims are denied, and what differences in industry practice there may be. We intend to focus on these issues in our follow up review starting in the next few months.

Review of general insurance claims handling and internal dispute resolution procedures

In August 2011 we published our review of general insurance claims handling and IDR procedures for motor vehicle insurance.

For consumers, a fundamental feature of an insurance product is the ability to make a successful claim when an insured event occurs. A claim may be successful at first instance, or if not, may subsequently succeed following further review through a dispute resolution process. The importance of efficient and reliable claims handling has been highlighted by the high volume of claims following the recent natural disasters in Queensland and other areas.

We considered it timely to review general insurance claims handling and IDR; in addition to recent changes in the general insurance industry, and changes which had been proposed to the *Insurance Contracts Act*, it would also allow us to test consumer concerns about the effectiveness of claims handling and IDR, and to gain a better understanding of insurance practices.

In relation to motor vehicle insurance we were pleased with generally positive high-level findings. Only a very small number of motor vehicle insurance claims are formally denied, and numbers of claims-related complaints also appear to be relatively low.

We did find some aspects of claims handling and IDR which warrant further attention. We think the recommendations in our report reflect best practice, and will help ensure more confident and informed consumers. We think that many of our findings and recommendations are likely to have a broader application across other general insurance product lines, including those with higher claims-denial rates such as travel insurance and CCI.

In relation to the participating insurers, we found that only 0.28% of claims were formally denied. However, approximately 7% of claims were *withdrawn* before a decision was made; and we had concerns with how some insurers recorded and reviewed information about denied and withdrawn claims. We recommended that insurers should record information about denied and withdrawn claims and should regularly analyse and review that information. Such a high level of withdrawn claims may suggest an expectation gap between what consumers understand their policy will cover and what it does in fact cover when put to the test in a claim situation.

We also found a difference in approach between insurers about the effect of a withdrawn claim on future premiums; and we recommended that where a withdrawn claim will result in an increase to future premiums, that should be disclosed. Insurers should also consider providing written confirmation of a decision to withdraw a claim.

In addition, ASIC looked at the issue of frontline staff providing advice about making a claim. Concerns were consistently raised by consumer representatives about an alleged practice of some insurers of suggesting to a policyholder over the telephone that their claim cannot or is unlikely to proceed or be accepted.

We found that some insurers authorise frontline staff to make claims decisions at the initial stage of contact, typically over the telephone. However this generally extends only to approving claims, with frontline staff having authorisation to deny claims only in very limited circumstances.

However, we made recommendations to further minimise the possibility of consumers with valid claims being discouraged from pursuing them. Where frontline staff can make a decision about making a claim, if they make a decision resulting in a claim being denied that should be reviewed before it is confirmed to the policyholder. We also recommended that insurers should review how frontline staff make such assessments, and how they communicate decisions to policyholders.

I note that the Insurance Council has recently approved changes to the General Insurance Code of Practice which should also address this issue by seeking to provide greater certainty for policyholders about their right to lodge a claim to test the question of policy cover.

For “uninsured motorist extension”, or UME, claims handling has been the subject of significant concern by consumer groups. We found a very low rate of UME claims, and a lower rate of acceptance of these claims than for other motor vehicle claims. We recommended that insurers review their conditions on UME claims, and review disclosure material to ensure that the information is accurate.

Our review of internal dispute resolution procedures found that insurers typically operate a multi-tiered IDR process, comprising frontline contact; tier 1, the complaints stage; and tier 2, the IDR stage. We recommended that insurers should review their systems and processes for recording and analysing Tier 1 complaints to align them with systems used at Tier 2, so that they can extract useful information to address underlying causes of complaints.

We recommended that decisions at Tier 1 should be confirmed in writing, and the content of these letters should be aligned with the final response provided at Tier 2, for instance, policyholders should be informed about external dispute resolution. This is consistent with our existing guidance on dispute resolution in RG 165.

ASIC also identified some issues with the accuracy and clarity of disclosure in relation to excesses and “no-claims discounts” schemes. We recommended that

insurers review and, if appropriate, improve disclosure, or provide more information about excesses and how no-claims discounts schemes operate. We intend undertaking further work in relation to no-claims discount schemes in 2012, specifically around the manner in which these schemes are marketed and disclosed to consumers having regard to all of the impacts of a claim on the future pricing of an insured's cover.

We think that insurers should be generally pleased with our findings in relation to claims handling. We encourage insurers to adopt our recommendations, both for motor vehicle insurance, and other types of insurance. Claims handling on home building and contents insurance has been a focus in recent government inquiries, and we have also received several complaints on this issue. It is therefore timely for insurers to especially consider these recommendations in relation to home insurance.

And as I mentioned, our work in relation to claims handling will continue this year focusing on consumer credit insurance.

Other emerging areas

Our work on “scaled”, or “limited” advice, in the context of the Government's Future of Financial Advice reform package, is another area of interest to the general insurance industry. Our work in this area is directed at providing increased certainty to industry about the provision of personal and general financial product advice. The guidance will also cover the distinction between factual information and financial product advice. This should assist licensees who not provide financial product advice. We want to guide licensees who hold personal information about their customers, and are concerned that this means that information provided to their customers will therefore automatically be personal advice.

By providing guidance to industry about these issues, we also aim to increase access to advice for consumers. We plan to include general and specific guidance about general insurance products in our regulatory guide. We acknowledge the industry's engagement in our consultation on this work which was very helpful.

Closing remarks

In closing, I note that at this forum 12 months ago ASIC flagged that it would be a busy year for the general insurance industry, and that ASIC's engagement with the industry would be more intense than it had perhaps been in the immediately preceding years. That prediction would appear to have been borne out. My observation, having recently joined ASIC as a Commissioner, is that this has been a very productive period with significant progress made.

ASIC appreciates the close working relationship we have with the general insurance industry and in particular the co-operative nature of that relationship, as demonstrated most recently in relation to our reviews of CCI and claims handling, as well as in the other regulatory work we undertake.

Further work lies ahead in the implementation of the Government's proposed reforms, and in the industry's plans to develop and refine the General Insurance Code of Practice, including some changes already agreed with members, as well as further consultation this year on possible additional changes. We look forward to working closely with the industry through all of these processes. I thank you for the opportunity to present to you today.

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