International Symposium

Enhancing Life Insurance Regulatory Regimes in ASIA

Global and Regional Regulatory Challenges

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Introduction

The key focus of this symposium is the prudential regulation of life companies. There is no doubt that prudential regulation of financial institutions such as life companies and banks is essential to ensure both the stability and integrity of financial markets. However, I am here not to talk about prudential regulation - but about regulation designed to promote consumer protection, which is what the organisation which I head, the Australian Securities and Investments Commission (ASIC) is responsible for.

The scope of ASIC's charter to ensure consumer protection and market integrity in financial markets has a very wide ambit, covering securities and futures markets as well as insurance, banking and superannuation (or pension fund) sectors. Therefore, I am going to focus on some broad aspects of consumer protection regulation, which underlie not only life company regulation but also other areas of financial markets which come under ASIC's regulation. These broad consumer protection considerations will also help me put into context the role of ASIC in the regulation of life companies, and ASIC's approach to its regulatory challenges.

The topics which I will discuss include:

- why consumer protection regulation is important for the efficient operation of financial markets;
- global and regional challenges to regulation; and
- how ASIC proposes to address some of these challenges.

Why consumer protection regulation is important for the efficient operation of financial markets

Economic and political considerations which underpin consumer protection regulation have a common application spanning across different sectors which constitute the financial markets These sectors cover products as diverse as bank deposits, shares, bonds, life insurance, superannuation and other funds management vehicles (such as unit trusts).

All regulation involves costs to all stakeholders, particularly:

- to market participants who offer financial products and services, as they generally incur the direct cost of compliance;
- to consumers, as some costs of service and product providers are often passed on to them; and
- to the tax payers, as their contributions are often used to fund the regulatory agencies and their operations.

So, how is regulation justified? The justification for promoting consumer protection in financial markets stems from the need to ensure that consumers have sufficient confidence to place their funds in the hands of those who offer financial products and services, without which, obviously, there will be no free flow of investment capital through financial markets to fund economic growth. Consumers will have no such confidence unless the financial markets are perceived to be a clean place to do business. Financial markets will not be perceived by consumers as a clean place to do business unless financial product and service providers operate with high levels of integrity and observe appropriate standards of conduct in their dealings with, or affecting, consumers.

If strictly policed prohibitions against fraud and misconduct can keep fraudsters away, and healthy competition can drive the inept and inefficient operators away, any further regulation of financial markets will have little justification to warrant the associated costs, such as those incurred through prudential and consumer protection regulation undertaken by APRA and ASIC. However, not only our own Australian experience but also the experiences of other well developed financial markets, such as the US and UK, have shown us, that these measures alone have not been sufficient to promote the integrity and efficiency of financial markets. Prudential regulation, of course, ensures the integrity and stability of the financial institutions, such as life companies, banks and superannuation or pension funds. This aspect of regulation promotes consumer confidence in financial markets by providing contract assurance, which is particularly important in the case of long term contracts such as those involving life insurance products. When investing in life products offered by life companies which are subject to sound prudential supervision, consumers can have the confidence that when their entitlements under the policy become due, the institution which sold the product will still be around and will be in funds, to be able to pay.

Again, if contract assurance alone was sufficient to augment sanctions against misconduct and competition in markets to promote efficient capital markets, there is no further justification for consumer protection regulation. As noted before, experience has shown us otherwise. Financial products and services are increasingly more complex. For example, in the life field alone, instead of risk only products, there have emerged investment linked life products. These investment linked products are linked to other financial products, such as managed investment products, shares, bonds and other assets, which are themselves increasingly more complex.

As a result, consumers do not necessarily have the expertise or the ability to understand the nature, or the suitability, of the financial products made available to them in financial markets. This raises the real risk of consumers picking unsuitable products, or financial commitments, with the attendant further risk of consumers becoming dissatisfied with products, services and their providers leading to inadequate and inefficient flow of investment funds to capital markets. Consumers' difficulties in choosing financial products and commitments that are suitable for their particular needs and financial circumstances are often exacerbated due to a number of reasons, which consumer protection regulation seeks to rectify. I will now focus on the core aspects of the consumer protection regulation which ASIC undertakes to address these consumer issues.

Adequate disclosure

Competition alone has never proven to be a sufficient incentive for financial product and service providers to disclose material information relating to the products they offer, so that markets and consumers can price the products at their fair value. In fact competition may lead to disclosure of only the positive features of the product, and no, or less than full and frank disclosure of the costs, or the conditions, or the exclusions, or the risks, information which is equally important to the decision making process of the consumer.

Therefore, to ensure that there is an adequate flow of disclosure to consumers and financial markets by persons providing financial products, we have regulatory requirements that mandate disclosure of material information by such parties. The objective of these requirements is to ensure that consumers are placed in a position to make well informed decisions when choosing financial products. ASIC considers itself as predominantly a disclosure based regulator, because we seek to fulfil our charter of consumer protection by empowering the consumers to make wise decisions based upon material information required to be made available to them through regulation, rather than protect them against their own unwise decisions.

In the life insurance arena, especially where life products are linked to investments, ASIC's regulation is directed towards ensuring that the life company issuing the product makes available to consumers adequate material information about the product to enable consumers to make a well informed investment decision when choosing that product. The disclosure requirements are, at this stage, not statutory, and are contained in an ASIC administered Code of Conduct.[1] The information required covers key aspects of the product such as a description of the product and its objectives, obligations and risks associated with the product and details relating to premium payments,[2] benefits available,

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[1] Disclosure Requirements for Promotional Material in the Life Insurance Industry - Life Circular No. G.I.1. this was formulated by ASIC's predecessor in insurance regulation, Insurance and Superannuation Commission, and is now administered by ASIC.

[2] Such as the frequency, amounts, any options to increase and the implications of ceasing to pay, premiums.

any investment options available and all fees and charges. This information must generally be set out in a documents titled "Key Features Statement", which consumers must be given before they make the purchasing decision.

Conduct standards

Disclosure of relevant information about the product alone is not sufficient to promote adequate consumer protection. Consumers often make their purchasing decisions based upon the information or advice given to them by persons engaged by product providers to promote the sale of their products. Much misconduct can occur at this point, as became evident after the pension mis-selling saga in the UK, where many thousands of investors were encouraged to change their existing pension arrangements for new arrangements, which of course generated higher income for the advisers, with disastrous consequences to the consumers. The resulting erosion of consumer confidence had a profound effect on the then Government of the UK, and in my view also can clearly be seen as the genesis of the complete overhaul of the regulatory structure undertaken by the current UK Government.

This is why it is important that there should be adequate regulatory mechanisms to ensure that consumers' interests are not adversely affected by the conduct of intermediaries, who provide the key interface with consumers in the distribution of financial products and services. If those intermediaries act without sufficient integrity, knowledge and expertise, interests of consumers who rely on their advice or services will be doomed. If those intermediaries sell products not because they are suitable for the consumer, but mainly to maximise their own income, interests of consumers will be undermined.

This is why regulation aims to impose entry level controls so that only such people who can demonstrate certain levels of integrity and competence are allowed to engage in selling and advisory activities. Regulation also imposes conduct standards that must be adhered to by intermediaries when engaging in selling and advisory activities. Some of those key conduct standards include processes that must be followed by an intermediary before recommending a financial product as suitable to a particular consumer (ie the requirements for a needs analysis of the consumer and adequate product research before making the recommendation) and disclosure of remuneration arrangements of the intermediary. These, and a whole set of other conduct standards,[3] which ASIC monitors and enforces, aim to promote consumer protection and market integrity, by minimising the adverse effect which conflicts of interests and other misconduct of intermediaries can have on interests of consumers.

In the life insurance industry in Australia, some of the key conduct standards applicable to intermediaries are partly found in the Code of Practice[4] and partly in legislation.[5] These aim to promote consumer protection by ensuring that at the point of sale of a financial product, and on an on-going basis, consumers have the benefit of a level of protection provided through minimum conduct standards imposed and policed by ASIC.

Global and regional challenges to regulation

Turning now to global and regional regulatory challenges which we face, the logical starting point is the convergence of financial products and markets, which would then lead us to what we can, without any hesitation, call the challenge of the century: the revolution brought about by rapid advancements in electronic communications, and the resulting e-commerce.

Convergence of financial products and markets, domestically and internationally

Financial products used to have distinct characteristics, based upon the distinct nature of the product involved, the institution offering the product, the nature of regulatory arrangements (including

[3] Such as standards relating to record keeping and audit requirements.
[4] Code of Practice for Advising, Selling and Complaints Handling in the Life Insurance Industry, Life Circular No. G.II.1.
[5] Insurance (Agents & Brokers) Act.

differential tax treatments) that applied to the product or any combination thereof. However, all of these boundaries have started to melt and converge due to a variety of reasons. Exchange rate deregulation and lifting of barriers to foreign investments in most jurisdictions, and, the effect of competition in financial markets, have significantly contributed towards convergence. Where the competitive forces in financial markets force profit margins low, product providers have a strong incentive to look for ways to reduce their costs. They have sought to achieve this by a variety of means, such as product innovation where hybrid products that straddle the boundaries of different product characteristics and regulatory regimes are produced, and through the establishment of financial conglomerates, which seek to take advantage of economies of scale in the distribution and management of financial products.[6] The regulatory divide between competing products was always likely to fall away in the absence of some compelling justification.

These convergences have been compounded and and international flavour either added or extended, by the rapid advances in information technology. Regulation is based on national sovereignty, and has become increasingly difficult to carry out in the face of Internet and other electronic communication mechanisms that are now available to product providers and consumers at very low costs. Product originators can reach potential purchasers of their products in the far flung corners of the globe, way beyond the national boundaries in which they are licensed or recognised. Often there is neither adequate regulatory compatibility nor enforcement capacity available to regulators to capture these activities within their regulatory ambit.

What do all these changes mean for consumers

I would like to now focus on what all these changes mean for consumers, because their needs and difficulties provide the basis for regulatory intervention from the consumer protection perspective.

All of these developments have brought in their wake both positive and negative results for consumers. On the positive side, the range and I would suggest, the quality, of financial products and services available in Australian financial markets have increased significantly, offering consumers a wider choice. The costs of products and services have also declined, resulting from competitive pressures and rationalisations resulting from those pressures. E-commerce has also made consumer access to products and services, nationally and internationally, more efficient both in terms of time and costs.

However, convergence of products and markets has also made it harder for the consumers, especially unsophisticated consumers (whom we refer to as retail consumers), to identify and understand product differences and the differences in the level of regulatory protection available to them because of regulatory differences (nationally or internationally) that may apply to such products.

For example, a consumer purchasing a managed investment product sold through a bank’s distribution network may not clearly understand that it is not a bank product which has the benefit of prudential regulation that generally applies, at least in the mind of the public, to any product of a “ bank”. Similarly, terms such as “capital guaranteed”, or “income guaranteed” may be construed by consumers as indicating a higher level of safety of the investment, which may or may not be the case. Also importantly, consumers do not necessarily know the differences in the level of regulatory protection available to them when choosing financial products offered from overseas jurisdictions, for example on the Internet. The attendant risk for the consumer is the selection of financial products or services that do not deliver the outcomes they expected from those products.

Another by product of growing convergence of markets is that financial products that are issued by issuers in one jurisdiction may have strong linkages to other foreign markets, mainly due to foreign investments in assets and services. This also means that financial institutions, financial markets and consumers in one jurisdiction can just as easily and quickly be adversely affected as institutions and consumers in a financial market in which a disturbance originates, due to these strong linkages. For example, the Malaysian currency crisis impacted consumers who invested in managed investment products offered by operators in other financial markets, such as in the UK and Hong Kong, where they invested in Malaysian securities.

[6] These pressures also led to rationalisation of regulatory arrangements in financial markets in Australia and the UK, which has led to a re-alignment of regulatory responsibilities to reflect the changes in financial markets without which effective regulation could not be delivered.

Consumers are also subject to increased marketing pressures, brought about by the increased penetration of households, and for that matter small business, by the Internet and other forms of electronic communications such as telemarketing. These mechanisms have the potential to lure unsuspecting consumers to make instant decisions to purchase financial products originating from less regulated and/or difficult to reach locations. Often, regulatory involvement is sought after the consumers parted with their funds, and the regulators are often helpless because the money has disappeared into an offshore financial centre beyond the reach of the regulator.[7]

The regulatory challenge for ASIC, as the consumer protection and market integrity regulator, is to ensure that consumers can derive the full benefit of the changes that have been brought about by the above changes without having to forego the level of protection intended to be delivered by regulation. This is the challenge which we face across the full spectrum of financial markets which are subject to our regulation, which includes regulation of life insurance. I would also think that this would be the regulatory challenge which you would have to face in order to be able to promote fair and efficient capital markets through regulation of life companies and life intermediaries.

How ASIC propose to address some of these challenges

It is our regulatory objective to help consumers take advantage of these global changes and to maximise the level of protection available to them. Some of the key objectives we seek to deliver through our regulation include:

- helping consumers to make well informed investment decisions,
- helping market participants to reduce their costs of products and services, where it can be done without minimising consumer protection;
- promoting better industry standards in the delivery of products and services; and
- promoting effective investor redress, where things go wrong with regard to the products or services they obtain.

Helping consumers to make well informed investment decisions

Mandatory product disclosure is the key to enabling consumers to make well informed decisions when selecting financial products and services. Given the increasing complexity of these products and services, it is important that information provided to consumer should be set out in easy to understand terms, not cluttered with sales jargon and marketing material. Not only the point of sale material such as the Key Features Statement provided to the consumer, but also the policy documentation, should be in clear and easy to understand terms. Consumers select insurance products for financial protection, such as protection against adverse financial circumstances resulting from a specified risk or for the provision of retirement income. Therefore, the information provided to them when selecting the product should deliver the desired outcomes. It is ASIC's charter to ensure that the information provided remains relevant, material and easily comprehensible by the consumer to help consumer make that decision wisely.[8]

ASIC also believes that consumer protection can be enhanced through effective consumer education programmes, so that consumers themselves can become more knowledgable and able to take care of themselves.[9] This is a responsibility that is to be shared by the regulator and the industry. This is

[7] ASIC had some success in the last 12 months recovering some A$4.7m from offshore centres, but that was exceptional, and related to securities fraud, not insurance.
[8] ASIC has introduced simpler prospectuses for managed investment funds, which aim to ensure that instead of a full blown prospectus, consumers have access to a much simpler product disclosure document which enhances consumers ability to easily understand the key aspects of the relevant information to make their investment decision.
[9] Other regulators in major financial markets such as the Securities and Exchange Commission in the US and the Financial Services Authority in the UK treat consumer education as a key to promoting

because it is not only the consumer, but also the market participants who offer financial products and services that benefit where consumers make well informed decisions, because it would inevitably lead to reduced costs associated with consumer complaints and increased consumer confidence in financial products and services. Therefore, ASIC will continue to undertake comprehensive investor education programmes, such as through investor forums (public meetings involving senior ASIC officers) and investor alerts (media releases intended for general audiences), to achieve its regulator goal of consumer protection.

Helping market participants to reduce their costs of products and services without minimising consumer protection

ASIC believes that regulation should not unnecessarily impede healthy competition in financial markets. Therefore, wherever possible, ASIC seeks to accommodate innovations in products and distribution methods evolving in financial markets, where it can be achieved without minimising consumer protection. A key example is where market participants encounter difficulties when complying with some of the regulatory requirements that are designed for paper based communications, where they wish to use electronic communications to market their products.

ASIC, upon requests from industry participants, would generally allow exemptions and modifications from the regulatory requirements to enable electronic communications, if the same level of protection provided under the paper based requirements can be achieved through other alternative standards. For example, in the life insurance arena, ASIC recently modified some of the requirements relating to paper based application forms to enable a life company to complete application forms over the telephone.

Promoting better industry standards in the delivery of products and services

ASIC recognises that regulation should not be the exclusive domain of the regulator. Industry involvement in regulating their own industry through the promotion and maintenance of better service standards is also a means by which better consumer protection can be delivered. One key area for promoting industry standards is industry Codes of Practice, which are developed and monitored by the industry itself, so that they have a direct ownership of those standards. ASIC's role where industry wishes to adopt such Codes is to provide input to the processes, to ensure that consumer protection needs are adequately addressed and, where necessary, approve and monitor such Codes.

In the life insurance area, as I have noted before, we have Codes of Practice that apply to life companies. However, these Codes were developed by ASIC's predecessor, the ISC, rather than by the industry itself, although there was comprehensive industry consultation. While some of the requirements contained in these Codes will become a part of a new statutory framework,[10] there will be other aspects which are best dealt with through industry Codes, such as telemarketing practices. Such an approach provides a higher level of flexibility to industry participants, while promoting consumer protection through improved industry benchmarks and standards.

Promoting effective investor redress

Another very important aspect of consumer protection is the provision of effective consumer redress. As we all know, judicial proceedings take a long time and involve high costs to all parties involved. No matter how effective the regulatory standards are, it is not possible to avoid consumer complaints resulting from disputes over the costs or features of financial products . Where consumers have complaints, it is important that they have access to complaints resolution processes that are time and cost efficient, without which consumer confidence in financial markets can be easily and quickly eroded.

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effective consumer protection. In fact the UK regulatory framework expressly recognises the role of investor education in consumer protection.

[10] Either through the Superannuation (Choice) legislation, or, through Corporations Law Economic Reform Program (CLERP 6) legislation.

This is why the regulatory regime in Australia now encompasses requirements that certain financial product and service providers have internal complaints resolution procedures that meet certain benchmarks, and also provide access to external complaints resolution mechanisms that are approved by ASIC. In the life insurance area, life companies have internal complaints resolution procedures that meet the necessary standards and also, they are members of the Financial Industry Complaints Scheme, which is their external complaints resolution scheme. These mechanisms provide consumers with an easy to access redress mechanisms, which are less time and cost consuming than having to take their complaints to courts. Consequently, these mechanisms contribute significantly to promoting consumer protection and therefore consumer confidence in financial markets.

Conclusion

The key message I would like to emphasise here is the importance of consumer protection to promote the integrity and efficiency of financial markets. Regulatory mechanisms which ASIC administers, such as the disclosure requirements and conduct standards, are designed to promote consumer protection in the regulation of financial markets including life insurance.

Without consumer protection, the objective of achieving efficient capital markets is likely to become illusory. This is because, without consumers' confidence, their funds are not likely to flow easily into capital markets to fund activities which sustain and fuel economic growth. In other words, the consumer protection regulation complements and supports in a very essential manner the objectives of prudential regulation, which is to promote the integrity and stability of the financial institutions and the wider financial markets within which those institutions operate.

Therefore, the message I would like you to take away from here is that regulation in the life arena, or for that matter in other financial sectors, should not focus only upon prudential regulation. It should also embrace consumer protection regulation, such as the regulatory role undertaken by ASIC. No country needs to suffer from any consumer backlash, before recognising the importance of consumer protection regulation and providing effective regulatory mechanisms to promote it.

Given that we live in the neighbourhood, and, given the close links our financial markets have with your financial markets due to convergence and other developments which I noted before, we are delighted to be working with you to achieve the goals of sound and efficient financial markets through sound regulation.