

FOS Submission

Addressing the high cost of home
and strata title insurance in North
Queensland



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1. Overview

This is the submission by the Financial Ombudsman Service (FOS) in response to the discussion paper released by Treasury *Addressing the high cost of home and strata title insurance in North Queensland* dated 9 May 2014 (Discussion Paper).

The submission has been prepared by the office of FOS and does not necessarily represent the views of the board of FOS. It draws on the experience of FOS and its predecessors in the resolution of disputes about financial services.

This submission deals only with one aspect of the Discussion Paper, namely the measure described in section 3.3 to relax restrictions on unauthorised foreign insurers (UFIs).

Our submission explains that:

- the Discussion Paper does not indicate whether the relaxation of restrictions would apply to UFIs that are not members of an ASIC-approved external dispute resolution (EDR) scheme
- if the relaxation would apply to these UFIs, it would increase the scope for insurance not covered by the current EDR arrangements

- Consumers with disputes against these UFIs could not use the EDR services put in place under the *Corporations Act 2001* (Corporations Act) for consumers of financial services
- increasing the scope for insurance for which consumers cannot access EDR would be a significant departure from the existing policy approach, which could result in unfairness to consumers and/or industry participants, and
- if restrictions on UFIs are relaxed as described in the Discussion Paper, consumers dealing with UFIs will not have some important safeguards that our system provides for other consumers of financial services.

We are concerned that there would be major gaps in the consumer protection provided to consumers dealing with UFIs. We consider that restrictions should only be relaxed for UFIs that:

- are members of an ASIC-approved EDR scheme, and
- are licensed by ASIC or meet other requirements to ensure that consumers can obtain effective redress in disputes with UFIs.

2. About FOS

FOS is an ASIC-approved independent EDR scheme that covers disputes across the financial sector.

FOS provides services to resolve disputes between member financial services providers and consumers, including certain small businesses, about financial services such as general insurance products.

FOS and its predecessor schemes have over 20 years' experience in providing dispute resolution services in the financial services sector.

As well as its functions in relation to dispute resolution, FOS has responsibilities to identify and resolve systemic issues and obligations to make certain reports to ASIC. FOS also monitors compliance with a number of industry codes of practice, including the general insurance code of practice.

In 2012-13, FOS accepted 24,100 disputes and closed 24,968 disputes.

Of these, 7,065 related to domestic insurance. 27% of the domestic insurance disputes related to home building insurance, 12% related to home contents insurance and 2% related to residential strata title insurance.

In recent years, FOS has participated in a range of consultations addressing general insurance issues. Our involvement has included making written submissions in 2011 to:

- the House of Representatives inquiry into the operation of the insurance industry during disaster events, and
- the Natural Disaster Insurance Review.

3. Discussion points

3.1 Background

The consumer protection measures in Australia's financial services legislation¹ include provisions for complaint handling. The legislation seeks to ensure that financial services providers deal properly with consumer complaints and, where the parties are not able to resolve complaints, consumers can access an independent EDR scheme.

The basic design is for adequate complaint handling by the financial services provider in the first instance - "internal dispute resolution" – then, where necessary, adequate EDR. Accordingly, the legislation requires certain financial services providers to have dispute resolution systems consisting of:

- internal dispute resolution procedures that meet standards imposed by ASIC and cover consumers' complaints about the services provided, and
- membership of one or more ASIC-approved EDR schemes to cover these complaints.

The two ASIC-approved EDR schemes within this framework are

¹ Corporations Act and *National Consumer Credit Protection Act 2009*.

FOS and the Credit Ombudsman Service. ASIC's Regulatory Guide 139² sets out the requirements that an EDR scheme has to meet to obtain and maintain ASIC's approval.

At present, the Corporations Act requires holders of an Australian Financial Services Licence (AFSL), and certain unlicensed financial services providers, to have membership of an ASIC-approved EDR scheme.³

3.2 Access to EDR

Section 3.3 of the Discussion Paper describes a measure involving relaxation of restrictions on UFIs. The paper states that, if the restrictions were relaxed, important consumer protections would not apply in respect of insurance purchased through UFIs.

The Discussion Paper does not explain whether the relaxation of restrictions would apply to UFIs generally or only to UFIs that are members of an ASIC-approved EDR scheme.

If the relaxation would apply to UFIs generally, it would increase the scope for a UFI without membership of an ASIC-approved EDR scheme to provide insurance to consumers.

² Regulatory Guide 139 *Approval and oversight of external dispute resolution schemes* on www.asic.gov.au under "Regulatory Documents".

³ Corporations Act subsections 912A(2) and 1017G(2).

Consumers with complaints against such a UFI could not access the EDR services put in place under the Corporations Act for consumers of financial services.

Access to EDR is an important element of consumer protection in Australia. If the relaxation of restrictions would increase the scope for a UFI without membership of an ASIC-approved EDR scheme to provide insurance to consumers, it would be a significant departure from the existing policy approach and disadvantage consumers purchasing insurance policies from UFIs.

The result would also potentially create an unlevel playing field to other financial services providers providing consumers with similar products who are members of an EDR scheme.

While we support the aims of reducing the cost of home and strata title insurance for consumers in these regions, we do not consider this should be at the cost of removing from consumers and small businesses the important consumer protection of access to EDR when problems under those policies occur.

3.3 Licensing and arrangements for handling insurance complaints

We can only provide effective dispute resolution services where our members are able, and have the incentive, to engage with the EDR process and comply with any decisions that bind them contractually.

The ASIC licensing regime and its obligations underpin the current EDR arrangements in the financial sector.

Legislation imposes requirements on licensees that enable EDR to operate effectively. For example, licensees must have:

- internal dispute resolution procedures that meet standards set through ASIC's Regulatory Guide 165⁴
- the resources required to participate in EDR, and
- adequate compensation arrangements.

Unlicensed UFIs may not be subject to any comparable requirements. They may not have the processes or resources that EDR scheme members need.

⁴ Regulatory Guide 165 *Licensing: Internal and external dispute resolution* on www.asic.gov.au under "Regulatory Documents".

If a licensee member of FOS fails to comply with a determination that we make against it, we can take the following steps:

- report the non-compliance to ASIC as serious misconduct (which ordinarily puts the member's licence at risk)
- move to expel the member from our membership and report this to ASIC (which also ordinarily puts the member's licence at risk)
- seek an order for specific performance of the membership contract in the courts, or
- any combination of the measures above.

If a non-licensee member fails to comply with a determination, our only option would be to seek an order for specific performance. The costs of this option may be prohibitive and if we obtained such an order against that member, they may not have the financial resources to pay our costs.

Giving consumers dealing with unlicensed UFIs access to an EDR scheme might create the impression that consumers have access to effective redress mechanisms.

However, in our view, such access would be in form only rather than in substance, leading consumers to

believe they have effective redress when this is not the case. This could adversely impact on the reputation of EDR as an effective form of consumer redress.

For the reasons explained above, we consider the relaxation of restrictions should only be made available to UFIs that:

- are members of an ASIC-approved EDR scheme, and
- hold an AFSL or meet some other form of licensing or comparable standards that ensure consumers can obtain effective redress in disputes with UFIs.

3.4 Impact on consumers

The Discussion Paper contemplates permitting UFIs to operate without meeting Australian prudential standards, including capital requirements.

It also states that the level of consumer protection for insurance provided through UFIs would be lower than for other insurance. In this scenario, consumers dealing with UFIs would not have some important safeguards that our system provides for other consumers.

3.5 Codes of Practice

The Discussion Paper does not indicate whether the measure to relax restrictions would apply only to UFIs that subscribe to the General Insurance Code of Practice. This code, which sets standards of good industry practice for insurers, contributes to consumer protection. Each code subscriber commits to:

- work to improve the standards of practice and service in their industry
- promote informed decisions about their services and
- act fairly and reasonably in delivering those services.

3.6 Need for access to EDR

For over 20 years, EDR arrangements have been in place for complaints relating to financial services. This reflects the widely accepted view that courts, alone, do not provide adequate access to redress for consumers of financial services. We consider that consumers could face particular difficulty in court action against a UFI and this suggests that consumers dealing with UFIs need access to EDR.

Specific considerations in this context include:

- The fact that a UFI is foreign itself complicates litigation against the UFI
- The costs of litigation against a foreign entity may be prohibitive
- A UFI that does not meet Australian prudential standards may not have sufficient funds to satisfy a court order and its financial position may be difficult for an Australian consumer to assess when considering litigation, and
- A consumer may not be able to enforce an insurance contract, or a court order, against a UFI.

4. Conclusion

In summary, FOS is concerned that the current proposals would remove an important protection for retail consumers and small businesses buying insurance policies. To ensure that EDR arrangements are effective, we consider that the restrictions should only be relaxed for UFIs that:

- are members of an ASIC-approved EDR scheme, and
- hold an AFSL or meet some other form of licensing or comparable standards that ensure consumers can obtain effective redress in disputes with UFIs.