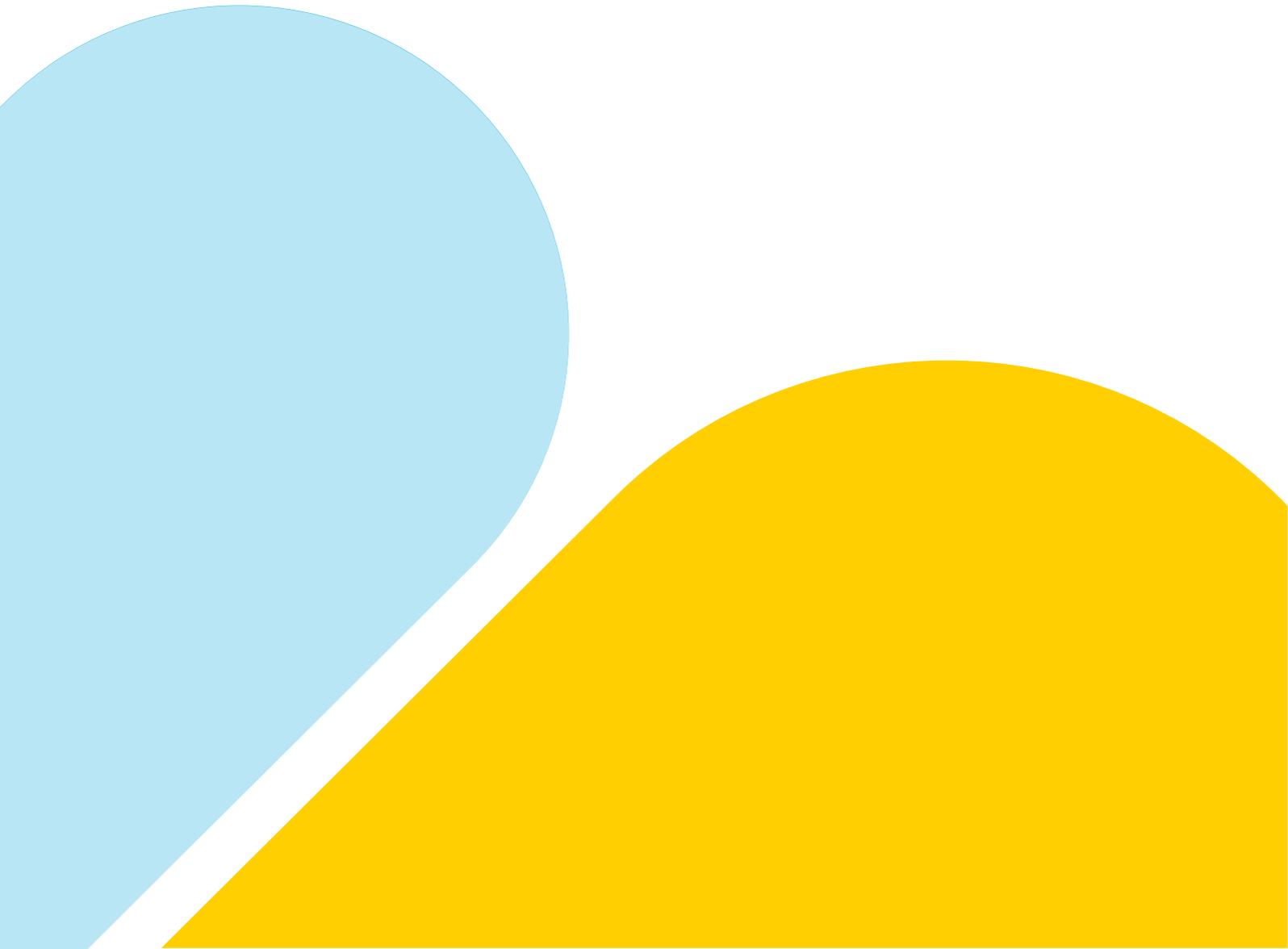


# Insurance claims handling

Submission to the Treasury consultation paper

Australian Financial Complaints Authority

4 April 2019



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# 1 Executive Summary

## Overview

The Australian Financial Complaints Authority (AFCA) welcomes the opportunity to make a submission<sup>1</sup> to the Treasury consultation paper on insurance claims handling.

AFCA is a new body that started on 1 November 2018 and now does the work previously undertaken by the Financial Ombudsman Service (FOS), the Credit and Investments Ombudsman (CIO) and the Superannuation Complaints Tribunal (SCT). The change to a single scheme implements the recommendations to Government made by the 2017 Ramsay Review.<sup>2</sup>

As a new organisation, AFCA has a fresh remit with new rules, operating procedures and a strategy that places fairness at the heart of everything it does.

AFCA handles complaints that consumers and small businesses may have with their financial firm. Consumers and small businesses can come to AFCA with matters relating to banking and finance, general insurance, life insurance, investments and advice and superannuation. AFCA's remit for the first time allows superannuation complaints to be handled by an ombudsman scheme. It also has a broader definition of small business, which means more small businesses now have access to EDR.

For consumers and small businesses, AFCA provides a simple and free alternative to going to court. Compared with its predecessors, AFCA has significantly higher limits on the claims it can consider and the compensation it can award.<sup>3</sup>

AFCA strongly welcomes the recommendations of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Royal Commission) and believes that these reforms are critical to ensuring that consumers and small businesses are treated fairly.

We acknowledge that trust in the financial services industry has been badly damaged. AFCA's role as an ombudsman is to provide fair and equitable outcomes that provide redress where consumers have not been treated fairly.

As recognised by the Financial System Inquiry, the key to building consumer confidence and trust is the fair treatment of consumers by financial firms. We believe that by extending the general obligations to require insurers to provide claims

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<sup>1</sup> This submission has been prepared by the Office of the CEO and Chief Ombudsman and does not necessarily represent the views of individual AFCA directors

<sup>2</sup> Review of the financial system external dispute resolution and complaints framework, 3 April 2017 ([Ramsay Review](#))

<sup>3</sup> AFCA has a claim limit of \$1 million and compensation cap of \$500,000 for consumer complaints. For small business credit facility complaints, a small business can lodge a complaint where the credit facility is of an amount up to \$5 million and will be able to receive compensation of up to \$1 million, and \$2 million for primary producers.

handling activities efficiently, honestly and fairly is a step towards re-building consumer confidence and trust in the financial services industry.

### Consultation paper

One of the recommendations made in the Final Report of the Royal Commission was that the handling and settlement of insurance claims should no longer be excluded from the definition of 'financial service', recommendation 4.8.<sup>4</sup>

The Government released its response to the recommendations made by the Royal Commission on 4 February 2019. In relation to recommendation 4.8, the Government announced it was supportive of removing the current exemption from the definition of a financial service.

Treasury's consultation paper, *Taking action on recommendation 4.8 of the Banking, Superannuation & Financial Services Royal Commission (Consultation Paper)* discusses the removal of the insurance claims handling exemption in the *Corporations Regulations 2001 (Corporations Regulations)* and proposes a "two-pronged approach" to implementing recommendation 4.8.<sup>5</sup>

The first step in the proposed approach is to remove regulation 7.1.33 of the Corporations Regulations. The second step is to define the activity of handling or settling an insurance claim as a 'financial service'.

AFCA notes the Government's response to implementing recommendation 4.8 and welcomes commitment to removing the exemption for the handling and settlement of insurance claims from the definition of financial service. We believe that this is an important step in recognising that financial firms have an obligation to their customers to act efficiently, honestly and fairly in every dealing or interaction they have.

### Conduct risk and fairness

AFCA has been an advocate for the introduction of a separate enforceable standard requiring financial firms and individuals working for them to treat customers fairly. In AFCA's response to the Royal Commissions' Interim Report<sup>6</sup>, we submitted that treating customers fairly should be made a standalone principle and enforceable standard for financial services entities and individuals working for them.

We stated that current regulation already references fair treatment of customers in requiring financial service and credit providers to deliver financial services fairly,

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<sup>4</sup> Final Report Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry Volume 1, pg. 33 and 307 – 309.

<sup>5</sup> Taking action on recommendation 4.8 of the Banking, Superannuation & Financial Services Royal Commission Consultation paper, pg. 9

<sup>6</sup> AFCA response to the Royal Commissions Interim Report, 26 October 2018, pg. 11 – 16

efficiently and honestly<sup>7</sup>, and those providing personal financial product advice to retail clients to act in the best interests of the client<sup>8</sup>.

We also identified what we perceive to be two limitations with the “efficiency, honestly and fairly” obligation. The first being that the obligation has been interpreted by the courts as a single composite concept, and the second is that the obligation operates at the licensee systems level.

While we consider these to be limitations with the current framework, the removal of the exemption for insurance claims handling would still introduce an obligation including an element of fair treatment of consumers.

This would in turn require insurers and their agents to consider and turn their minds to the way in which they handle and settle their insurance claims and ensure that their claims managements processes ensure the delivery of an “efficient, honest and fair” claims process. We consider this to be an important step towards enhancing the rights of consumers to be treated fairly.

### Scope of this submission

In this submission we provide information about AFCA and its role as an important mechanism for consumers and small businesses to obtain access to justice for complaints they have about their financial services. We broadly address the questions raised in the Consultation Paper and provide our insights from our complaint resolution experience and welcome the opportunity to comment on this important topic.

## 2 Introduction

### The role of AFCA

The Australian Financial Complaints Authority (AFCA) is a free, fair and independent external dispute resolution (EDR) scheme. Our role is to assist consumers and small businesses to reach agreements with financial firms about how to resolve their financial services complaints. We can consider complaints about banking and finance, insurance, superannuation and investments and financial advice matters.

We are impartial and independent, we do not act for either party. If a complaint does not resolve between the parties, we will decide an appropriate outcome. AFCA’s service is offered as an alternative to tribunals and courts to resolve complaints consumers and small businesses have with their financial firms.

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<sup>7</sup> s.912A(1)(a) of the Corporations Act 2001 obliges financial services licensees to do all things necessary to ensure that the financial services covered by the licence are provided efficiently, honestly and fairly. This applies to the overall provision of financial services by the licensee. Section 47(1)(a) of the National Consumer Credit Protection Act 2009 puts the same obligation on credit licensees when engaging in authorised credit activities

<sup>8</sup> See Part 7.7A of the Corporations Act 2001

## **AFCA's decision-making approach**

Inherent in AFCA's purpose and values is the provision of a fair and independent service. Fairness is one of the key principles which underpins the AFCA scheme and is a central element of AFCA's decision-making approach. Complaints are considered objectively and without bias, by staff and decision makers with appropriate expertise.

Our Rules require that we provide procedural fairness to all parties to a complaint. This means that before we make a decision on a complaint, both the person making the complaint and the financial firm must be provided with relevant information which we intend to rely on and have an opportunity to provide their views, and a response.

Our decisions must fairly reflect the information provided to us and apply the decision-making criteria in the Rules. While every decision made by AFCA will have unique features, and decision makers must consider a complaint's particular facts, stakeholders should expect that decisions made about complaints with similar issues would result in consistent outcomes. Central to this is that all decisions are fair, balanced and considered.

AFCA Rule A.14.2 provides that an AFCA Decision Maker must do what is "fair in all the circumstances" when determining a complaint. In doing so, the AFCA Decision Maker must have regard to legal principles, applicable industry codes or guidance, good industry practice and previous relevant scheme determinations. Importantly this means that an AFCA Decision Maker is not bound to simply apply the law.

## **Exemption to the obligations of financial service licensees**

In order to run a financial services business, and provide financial services or products to clients, you will generally need an Australian Financial Services Licence (AFSL). An AFSL authorises the holder of that licence or its representatives to provide financial services to clients.<sup>9</sup>

Under the current regulations, a person is considered to be providing a financial service if they provide financial product advice or deal in a financial product.<sup>10</sup> Generally, a financial product is a facility provided to an individual allowing them to make a financial investment, manage financial risk or make non-cash payments, such as a general insurance policy.<sup>11</sup> Dealing in a financial product involves conduct that, in some way, 'deals' with the product for example, applying for it, buying it, changing it or disposing of it.<sup>12</sup>

There are a series of obligations placed on financial services licensees, including a number of general obligations that they must adhere to.<sup>13</sup> These general obligations include, amongst other things, doing all things necessary to ensure that the financial

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<sup>9</sup> Corporations Act 2001, Section 911A

<sup>10</sup> Corporations Act 2001, Section 766A

<sup>11</sup> Corporations Act 2001, Section 763A

<sup>12</sup> Corporations Act 2001, Section 766C

<sup>13</sup> Corporations Act 2001, Section 912A

services are provided efficiently, honestly and fairly.<sup>14</sup> This general obligation however does not currently apply to insurers in their handling and settling of insurance claims due to the exception out in regulation 7.1.33 of the Corporations Regulations<sup>15</sup>.

It is understood that this exception was originally put in place to allow insurers to process insurance claims, including having discussions with their customers, without triggering the financial advice rules and requirements.

The issue of the insurance claims handling exemption has been raised before. Most recently, in March 2018, the Parliamentary Joint Committee on Corporations and Financial Services (Joint Committee) released its report following an inquiry into the Life Insurance industry. The Joint Committee recommended a review of the claims handling exemption to determine if it limits ASIC's ability to oversight the claims handling processes of insurance companies.<sup>16</sup>

In October 2016, ASIC released its report on the review life insurance claims. ASIC recommended that the exemption be removed as this would enhance its ability to seek improvements in claims handling practices.<sup>17</sup>

As the evidence presented to the Royal Commission has shown, this exception in its current form is no longer appropriate, nor does it meet community expectations. Commissioner Hayne concluded that there is no basis for suggesting an insurer should not be required to handle claims fairly, efficiently and honestly.<sup>18</sup>

As submitted by ASIC, the intrinsic value of an insurance product for a consumer lies in the ability to make a claim when an insured occurs.<sup>19</sup> Having to make a claim on an insurance policy is usually due to unfortunate circumstances or events. In the eyes of a consumer, the claims management process is the most important dealing they will have with their insurance company or in connection with their insurance policy.

AFCA believes that the standard of conduct and community expectation for a financial firm to treat their customers fairly and provide services efficiently and honestly should always form part of a financial firms' obligations to their customers.

We believe that the removal of the claims handling exemption is an important step towards advancing the standard of conduct requiring customers to be treated fairly when they are dealing with their financial firms.

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<sup>14</sup> Corporations Act 2001, Section 912A (1)

<sup>15</sup> Corporations Regulations 2001, Regulation 7.1.33

<sup>16</sup> Report by the Parliamentary Joint Committee on Corporations and Financial Services, Inquiry into the Life Insurance Industry, 27 March 2018, pg. xxii

<sup>17</sup> ASIC Report 498, Life insurance claims: An industry review, October 2016, pg. 11 and 102

<sup>18</sup> Final Report, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry Volume 1, pg. 308

<sup>19</sup> ASIC Submission, Round 6: Insurance, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, 25 October 2018, pg. 27

## A Who should be covered

### Who would be covered?

Given the scope of the proposed new financial service, it is expected that the following persons would be covered:

- Insurers that provide a claims handling service. This would include the insurer's employees (broadly defined to include contractors) and related body corporates of the insurer and their employees (broadly defined to include contractors) if they provide a claims handling service on behalf of the insurer;
- Certain third-party representatives of insurers that provide a claims handling service on behalf of the insurer. It is likely that third party representatives (which could be identified using a title such as 'claims handling service providers') would need to include service providers such as investigators, loss adjustors, loss assessors, collection agents and claims management services; and
- Other persons that ASIC declares are included. This would give ASIC the power to include other entities if problematic conduct is identified in the future.

When a customer makes an insurance claim, they don't get a choice in who they deal with during the claims management process in the handling and settling of that insurance claim. AFCA considers that the standard of conduct to treat customers fairly and provide financial service efficiently and honestly is primarily owed by the insurer and its employees.

However, insurers need to be responsible for the conduct of their agents and contractors. They should not be able avoid any of their obligations to their customers by contracting out any aspects of its operations to third parties, including claims handling.

AFCA considers that the scope of the new proposed financial service should directly cover insurers, their employees (including contractors), and any related body corporates and their employees, if they provide any service in connection with the handling or settling of an insurance claim.

It should be expressly stated that insurers will be liable for any failure to comply with any obligation imposed on them in connection with the provision of the financial service, including any outsourced functions to third parties in connection with claims handling.

We also consider that the new proposed financial service should capture any third parties engaged by the insurer or any related body corporates that provide any service in connection with the handling or settling of insurance claims.

## B Application to all claims

### **Application to insurance products**

Consistent with the recommendation of the Royal Commission, the proposal will apply to all insurance products including general insurance products, life risk products and investment life insurance products and group life insurance products.

The issues identified by the Royal Commission and ASIC on the handling and settling of insurance claims have generally related to retail clients. An option would be to limit the definition of claims handling activity to services provided to retail clients.

However, consideration would need to be given to whether the definition of retail client in relation to general insurance products (which, under section 761G(5) of the Corporations Act, is restricted to specified kinds of general insurance product) would result in claims handling conduct requirements not applying to a significant number of policies commonly acquired by individuals or small businesses.

AFCA supports the proposal applying to all insurance products, including general insurance and like risk products, as well as investment life and group life products. We note that this is consistent with the recommendation made by the Royal Commission and consider that all insurance products should receive the same level of regulation and oversight, and financial firms should owe the holders of any insurance policy the same obligations.

AFCA believes that the general obligations<sup>20</sup> of financial service licensees contained in the Corporations Act are appropriate obligations for all insurance products and do not see any reason that an insurer should not be required to meet these for all the claims that they handle.

The type of insurance product that a claim is being made under should not detract from an insurers obligation to handle or settle that claim “efficiently, honestly and fairly”, ensure it manages conflicts of interest appropriately or have adequate resources in place to deal with that claim, including appropriately trained and skilled staff. These are matters which any customer would expect of any financial service provider in the provision of any financial service.

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<sup>20</sup> Division 3 Part 7.6 Corporations Act 2001

## C Definition of claims handling as a financial service

### Consultation question 4:

How could the activity of handling or settling an insurance claim (in relation to both life and general insurance products) be defined as a financial service for the purposes of the Corporations Act?

As mentioned earlier in this submission, in ASIC's round six submission to the Royal Commission, it said the intrinsic value of an insurance product for a consumer lies in the ability to make a claim when an insured occurs.<sup>21</sup>

AFCA believes that any definition which is applied to the activity of handling or settling an insurance claim should be broad in nature to capture any activity which an insurer, or any third party engaged by the insurer, may perform or undertake in connection with the handling or settling of an insurance claim, and any other aspect of their claims management process.

Examples of activities could be modelled of the current examples of services contained regulation 7.1.33, including interpretation of policy, claims strategy, recommendations on loss mitigation, estimates of loss or value.

Examples should also include broader claims management activities such as lodgement, assessment, investigation and decisions, as well as a service element covering communications with insureds by insurers and any third parties they engage in relation to a claim.

AFCA supports the key requirements that would apply to any definition of the handling or settling of an insurance claim being those contained in Division 3, Part 7.6 of the Corporations Act, being the obligations of financial service licensees.

This would also enhance ASIC's oversight ability regarding insurance claims handling, and enable ASIC to request information, receive notifications on certain matters, as well as its ability to undertake surveillance.

This division includes the obligations to provide financial services "efficiently, honestly and fairly", effectively manage conflicts of interests, have adequate resources and ensuring employees are appropriately trained. We believe that these general obligations are in line with what the community would expect of any financial service provider, including during the claims management process.

AFCA considers that any obligation in connection with the claims management process must start from when a customer intends to lodge their claim and carry on until the claim is settled.

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<sup>21</sup> ASIC Submission, Round 6: Insurance, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, 25 October 2018, pg. 27

We believe that the trigger for any obligation on an insurer should be when a customer takes action with the intention of making a claim under their insurance policy. These obligations should continue throughout the duration of the claim until it is finalised in its entirety.

We consider that an insurer should have positive obligations to assist their customers in lodging or submitting their claims, as well as guiding them through the claims process to ensure they receive their full entitlements under the terms of the policy, to ensure provision of a fair, efficient and honest service.