INSURANCE COUNCIL OF AUSTRALIA

EDR Review Secretariat
Financial System Division
Markets Group
The Treasury
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25 January 2017

Dear Sir/Madam

Interim Report – Review of the financial system external dispute resolution and complaints framework

The Insurance Council of Australia (ICA) welcomes the opportunity to respond to the Interim Report for the above review (the Interim Report).

The ICA is the representative body of the general insurance industry in Australia. Our members represent more than 90 percent of total premium income written by private sector general insurers. ICA members, both insurers and reinsurers, are a significant part of the financial services system.[1]

ICA members provide insurance products ranging from those usually purchased by individuals (such as home and contents insurance, travel insurance, motor vehicle insurance) to those purchased by small businesses and larger organisations (such as product and public liability insurance, professional indemnity insurance, commercial property, and directors and officers insurance).

The Interim Report provides a comprehensive analysis of Australia's financial services external dispute resolution (EDR) framework. We are pleased that the Panel has recognised the strengths of industry ombudsman schemes and considers an industry funded model well placed to meet the core principles governing the Review.

We welcome the Panel's first draft recommendation that a new single ombudsman scheme for financial, credit and investment disputes be established. As we will detail later in our submission, care must be taken to ensure that the new scheme is established with minimal disruption and confusion to consumers and industry.

[1] September 2016 Australian Prudential Regulation Authority statistics show that the private sector insurance industry generates gross written premium of $44.1 billion per annum and has total assets of $120.5 billion. The industry employs approximately 60,000 people and on average pays out about $124.6 million in claims each working day.

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The ICA particularly supports the Panel's observation with regards to the House of Representatives Standing Committee on Economics' *Review of the Four Major Banks: First Report*. The Panel has noted that an industry ombudsman scheme can adequately meet many of the Committee's recommended features of the proposed Banking and Financial Sector Tribunal. As noted in the Interim Report, the ombudsman model is free to consumers, decisions are binding on members and it is funded by the financial services industry.[2]

The ICA is also pleased to note that on this matter both insurers and consumer representatives are in agreement. We hope for a strong endorsement from the Panel in the final report, that an ombudsman scheme is a more effective model for financial services dispute resolution than a tribunal.

The ICA is extremely concerned with the Panel's observation that there is merit in introducing an industry-funded compensation scheme of last resort. While we recognise that measures should be taken to assist those consumers who remain uncompensated despite an Ombudsman determination, we remain firmly of the view that a targeted solution should be developed to address this, not an industry-wide compulsory approach.

Please find attached more detailed feedback on the recommendations. We have restricted our comments to those recommendations that pertain to the general insurance industry. If you would like to discuss further any of the issues covered in this submission, please contact Sarah Phillips, Acting General Manager Consumer Relations and Market Development on 02 9253 5120 or sphillips@insurancecouncil.com.au

Yours sincerely

Robert Whelan
Executive Director and CEO

[2] Interim Report, p 158

ICA Responses to the Interim Report draft recommendations

Draft Recommendation 1 – A new industry ombudsman scheme for financial, credit and investment disputes

The ICA supports the recommendation for a single ombudsman for financial, credit and investment disputes. We consider that the scheme will have the potential to deliver a more streamlined consumer experience and facilitate efficiencies due to the sharing of resources and back office functionalities.

We have been a strong supporter of the general insurance industry's existing EDR arrangement with the Financial Ombudsman Service (FOS). Over the years, consumer representatives and industry have worked closely with FOS as they have sought to improve their processes and eliminate backlogs. This improvement in efficiency is supported by data published in the FOS 2015 -16 Annual Review which states that the average time taken to close disputes reduced from 95 days in the previous financial year to 62 days in 2015 -16. Further, the proportion of disputes closed within 30 days almost doubled from 22% to 43%.[3]

Taking into account the considerable effort by FOS to develop and maintain these improvements, the ICA supports the creation of a new industry ombudsman scheme, in so far as the existing arrangements between industry and FOS are not overly disrupted.

It would be extremely unfortunate if the very purpose of a single ombudsman – to improve consumer access to EDR – was undermined by backlogs and delays as new processes are established. We note that in their submission to the EDR Issues Paper, consumer representatives also recommended that changes to dispute resolution in the financial system should build on the 'largely successful operation of the FOS'.[4]

The interim report has provided preliminary observations on the features of the single industry ombudsman scheme.[5] We support the Panel's recommendations with regards to the scheme's powers and approach to decision making, governance arrangements and funding. The high level features outlined under these headings are consistent with current FOS features.

With regards to the jurisdiction of the single industry ombudsman, the ICA supports the new scheme's jurisdiction covering the consumers and the products and services currently covered by FOS. We do not agree that monetary limits and compensation caps should be increased without further consultation. We discuss our views on this in more detail under the next two recommendations.

[3] FOS Annual Review 2015 – 16, p 9
[4] Joint Consumer Group 2016, submission to EDR Review Issues Paper, p 2
[5] Interim Report, p 147

INSURANCE COUNCIL OF AUSTRALIA

Draft Recommendation 2 – Consumer monetary limits and compensation caps

The Panel states, quite firmly, that the current monetary limit of $500,000 and compensation cap of $309,000 is inadequate and should be increased. The ICA notes the views of the Australian Bankers' Association that consumers should be able to bring complaints up to the value of $1 million and schemes should be able to make an award of up to $1 million.[6] Consumer groups have suggested $2 million and proposed that limits and caps be periodically reviewed.[7]

The ICA agrees that monetary limits and compensation caps must be indexed to remain aligned with economic parameters. However, the ICA does not support an increase in the cap to $1 million, or any increase determined outside of a specific consultation process between the new industry ombudsman scheme and its stakeholders. We strongly caution against introducing higher limits, especially for financial products that typically have moderate average claim amounts such as general insurance claims, in the absence of compelling evidence that the current limit is inadequate for these products.

FOS Terms of Reference clause 9.8 stipulates that monetary amounts should be adjusted by the higher of the percentage increase in the Consumer Price Index or the Male Total Average Weekly Earnings. The clause also states that in addition to these adjustments, the Board of FOS, in consultation with financial services providers and other stakeholders such as key consumer organisations should periodically review the monetary limits.[8]

The ICA submits it would be more constructive for the Panel to recommend that a similar provision is included in the Terms of Reference of the new single ombudsman scheme. Determining limits and caps in the absence of such a process would be arbitrary. Recommending that a clause similar to 9.8 is adopted would provide for a full and thorough consultation process. It would also ensure that the amounts are subject to regular review, as recommended in the joint consumer submission.

The ICA considers it worth noting that while some have pointed to the UK Financial Ombudsman Service as an example of best practice, the maximum money award that the UK Ombudsman can make is £150,000 which is approximately $250,000.

While the ICA and members support an ombudsman scheme for small disputes as an efficient and cost effective means to provide compensation, the procedures developed for dealing with small and relatively simple claims will not be appropriate for complex and high value claims.

ICA members have considerable reservations about a $1 million or $2 million compensation cap. These high value determinations would not be bound by the same rules and procedures that apply in the courts, for example:

- There is no right to appeal a determination;
- Determinations are not binding on the consumer;
- The Ombudsman is not bound by rules of evidence or legal precedent; and
- There is no facility for witnesses to be cross-examined under oath.

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[6] Australian Bankers Association, submission to the EDR Review Issues Paper, p 5
[7] Joint Consumer Group, submission to the EDR Review Issues Paper, p 42
[8] ASIC-approved FOS Terms of Reference effective from 1 January 2015, clause 9.8.

As the above are not in keeping with standard legal and court practices, they are in direct conflict with some of the basic assumptions of the professional indemnity (PI) insurance model - the mechanism by which compensation awards against licensees are paid. It is important that the Panel takes into consideration the consequential impact that an increase in compensation limits will have on PI insurance. In particular, the inability to appeal determinations means there is no mechanism to test their soundness.

Increasing compensation limits, quite drastically from $309,000 to $1 million or $2 million, would lead to a material adjustment in the PI insurance model and for general insurers more broadly. The existing process, in which legal precedent does not apply and is not binding, already poses challenges for general insurers. This includes the question of whether future claims should be decided in accordance with the Ombudsman's decision in individual claims, or established court precedent. Insurers must also decide how the uncertainty created when legal precedent is not followed should be factored into premium pricing. Increasing monetary limits and compensations caps without addressing this, is likely to intensify the issues and create greater uncertainty.

The ICA strongly recommends that these matters be fully worked through in consultation with the Board of the new industry ombudsman scheme and stakeholders before recommendations to increase the caps are put forward.

Draft Recommendation 3 – Small business monetary limits and compensation caps

The Panel has proposed that the new industry ombudsman scheme provides small businesses with monetary limits and compensation caps that are higher than the current arrangements. The Panel noted that an increase in monetary limits would help to improve access to dispute resolution for small businesses.

With regards to small business insurance disputes, the ICA has not been made aware that the cap has resulted in a lack of access.

We note that FOS has recently consulted on increasing monetary limits and compensation caps for small business credit disputes.[9] For similar reasons as detailed under draft recommendation 2, the impact on those who provide insurance to credit providers must be taken into consideration. The ICA would welcome the opportunity to discuss potential ramifications with the Board of the new industry ombudsman.

Draft Recommendation 5 – A superannuation code of practice

The ICA welcomes the Panel's positive remarks with regards to industry codes of practice. In particular the Panel's recognition that codes of practice help raise industry standards, enhance confidence in industry and are able to respond to changing consumer expectations.[10]

As the Panel recommends that the superannuation industry adopt a code of practice, the ICA considers this an opportunity to restate the effective relationship between FOS and the FOS

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[9] FOS, *Expansion of FOS's Small Business Jurisdiction: Consultation Paper*, August 2016
[10] Interim Report, p 154

Code Compliance team and the ability for FOS to easily notify the general insurance industry's Code Governance Committee of emerging trends and possible code breaches. The ICA recommends that this nexus is maintained under the new industry ombudsman body.

Draft Recommendation 6 – Ensuring schemes are accountable to their users

The ICA supports the Panel's draft recommendation that the new scheme should be required to meet standards developed and set by ASIC. We also agree with the Panel's proposals that the scheme should have sufficient funding and flexible processes. This is particularly important for general insurance disputes where events such as natural disasters could lead to unforeseen increases in dispute numbers.

We support the Panel's recommendation that there should be an appropriate level of financial transparency to ensure the scheme remains accountable to users and the wider public. It is important that the new single ombudsman scheme provides clarity around fee structures and charges to all stakeholders including the financial service firms who are funding the scheme.

The Panel has recommended that the new scheme be subject to more frequent, periodic independent reviews. At present FOS is required to undertake an independent review every five years. There may be some merit in reducing this period to every three or four years, however the right balance must be maintained.

Most important is that a full and thorough independent review is carried out and that, following this, there is time for the recommendations to be implemented, embedded and then evaluated. Increasing the frequency of reviews may not be the most appropriate way to achieve this. Indeed it may be counter-productive, if sufficient time has not passed to appropriately evaluate the outcomes from the last review.

The ICA suggests that it would be more helpful to stipulate periodic independent reviews combined with ongoing opportunity for stakeholder consultation and feedback. This should facilitate constructive, continuous development.

The ICA supports the establishment of an independent assessor to review the handling of complaints by the scheme. The assessor should be available to both consumers and financial service providers. This could work alongside the ability to grant financial service providers the right to appeal a determination to genuinely test the handling of complaints and disputes.

Draft Recommendation 7 – Increased ASIC oversight of industry ombudsman schemes

The ICA considers that the current arrangement, whereby ASIC must approve an EDR scheme, is working effectively. We note that the Panel is concerned that ASIC's influence rests too heavily at the point of approval and oversight diminishes once the scheme is in operation.[11]

[11] Interim Report, p 48

The ICA has observed a close and effective relationship between FOS and ASIC. In particular, the requirement for FOS to consult with ASIC about the terms of the mandated independent review and the appointment of the reviewer. We also note that FOS Terms of Reference require FOS to provide reports and recommendations about a financial service provider to any regulator such as ASIC. FOS is also required to report to ASIC on systemic issues and we understand that FOS provides quarterly reports to ASIC on the numbers of possible and definite systemic issues it has identified.[12]

The ICA submits that similar requirements should be established between the new single ombudsman and ASIC. The governance arrangement should provide for an effective Board that is independent, fair and obliged to operate in close consultation with ASIC.

ASIC should ensure that the new scheme is compliant with the standards set out in its regulatory guidance, however clear boundaries must be established to ensure the scheme operates with accountability to ASIC yet remains independent. The Panel has suggested that ASIC could be provided with the powers to require schemes to undertake targeted reviews of particular types of disputes.[13] We would welcome further consultation on this matter to better understand the types of issues the Panel is trying to address and ensure the most appropriate solution is developed.

Draft Recommendation 8 – Use of Panels

The ICA supports the recommendation that the new industry ombudsman should consider the use of panels for resolving complex disputes.

In their General Insurance and Investments and Advice divisions, FOS currently use expert panels to make determinations about complex disputes. The panel members are appointed by the Board based on a variety of criteria including objectivity and experience.

If the definition of complex is consistent with that currently used by FOS, it would be prudent for the new industry ombudsman to adopt a similar approach. We also agree that the new ombudsman should provide greater information as to when and why a panel is used as opposed to an ombudsman determination. The ICA recommends that criteria is developed to clarify when and how panels are used. This will assist with managing resources and costs involved with running panels, and result in more efficient outcomes for consumers.

Draft Recommendation 9 – Internal Dispute Resolution

The Panel is recommending that ASIC should be able to collect and report individual firm's dispute data at the internal dispute resolution (IDR) stage.

For the general insurance industry, IDR data is reported, in aggregate, by the Code Governance Committee in the General Insurance Industry Data Report. The report analyses data about policies, claims, declined claims, withdrawn claims, internal disputes and their outcomes across personal classes of general insurance.[14]

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[12] FOS Annual Review 2015 – 16, p 9
[13] Interim Report, p160
[14] General Insurance Code Governance Committee, *The General Insurance Industry Data Report 2014-15*

To avoid duplication, ASIC should work with the respective code committees to establish reporting consistency that will assist ASIC with monitoring trends and identifying emerging issues.

The ICA would caution against publishing firm-specific internal dispute resolution data particularly without accompanying data on a firm's size and nature of products. Raw data may not prove useful for benchmarking purposes or consumer insight. Indeed, without contextualisation, the data could be misleading and stakeholders may find it difficult to draw meaningful conclusions. It is reasonable to assume that different financial service providers may record and track their IDR processes in varying ways. To ensure consistency and therefore appropriate consumer outcomes, the ICA would encourage further consultation with industry and the respective code committees. Appropriate transition times will also be required if additional reporting procedures are established.

The ICA does not support the Panel's recommendation for a reduction in IDR timeframes. While many complaints are resolved well within the 45 day period, some require more time. A reduction in timeframes could result in suboptimal outcomes for consumers and financial service providers, for example, insurers may experience delays in IDR if a consumer needs to gather additional information to support their claim. We submit that measures stipulating that customers must be kept informed about the status of their dispute are more effective than reducing IDR timeframes.

Draft recommendation 10 – Scheme to monitor IDR

The ICA supports the new industry ombudsman registering and tracking the progress of disputes when referred back to the financial service provider. This currently occurs with FOS and it provides insurers with a further opportunity to resolve the dispute at the IDR stage.

Panel observation – Compensation scheme of last resort

The ICA does not support the Panel's observation that a compulsory industry-funded compensation scheme of last resort is required due to the current 'gaps' in the dispute resolution framework.[15]

As is noted in the Interim Report, statutory compensation arrangements already exist in many areas of financial services. These sector-specific arrangements have been constructed with regards to the requirements and design of the sectors to which they apply. The ICA is unaware of any findings that demonstrate their inadequacy.

The Panel has reported that the Australian Bankers' Association and FOS are working with other key stakeholders to identify issues that would impede the implementation of a compensation scheme of last resort. The Panel has noted that it will consider the outcome of this work in the context of the Final Report.[16]

The ICA strongly recommends that alongside this, the Panel gives considerable attention to the recommendations of the April 2012 review by Richard St. John into a statutory

[15] Interim Report, p 166
[16] Interim Report, p 168

compensation scheme for financial services.[17] The review, which entailed research, information gathering, consultation and deliberation with industry, consumer representatives and regulators, provides a comprehensive assessment of the costs and benefits of a statutory compensation scheme. As such, it is of vital importance to the Panel's observation and we encourage the Panel to take the review's findings into account.

Following the robust review process, in his letter to the Minister for Financial Services and Superannuation, Richard St. John ultimately concluded that:

'… it would be inappropriate, and possibly counter-productive, to introduce a more comprehensive last resort compensation scheme to underpin the current relatively light compensation regime for financial advisers and other providers of financial services…it would be inappropriate to require more responsible and financially secure licensees to underwrite the ability of other licensees to meet claims against them for compensation.'[18]

The Panel has noted that adequate PI insurance is the usual means by which firms ensure they have arrangements in place to compensate consumers when losses arise. However, the Panel details the limitations in using PI insurance as a compensation mechanism.[19]

The ICA submits that PI insurance operates to ensure that the majority of compensation awards against licensees are paid. However, we agree that the risk still remains that compensation payments may not be made.

While figures from FOS reveal that more than $17 million in determinations made in favour of complainants has not been paid[20], the ICA would welcome further analysis to understand the contributing factors behind this amount. For example, if it is ascertained that the predominant factor is underinsurance, the ICA submits that an appropriate mechanism to resolve this would not be a compensation scheme of last resort but a greater onus on ASIC to ensure that AFS licensees have adequate PI insurance.

In ASIC's Regulatory Guide 126, it is noted that an AFS licensee should consider if the level of indemnity cover is adequate to cover liability arising under an award made by an EDR scheme.[21] More proactive enforcement of this requirement would assist with ensuring that the level of PI cover held is appropriate and should mitigate against the issue of unpaid determinations.

Complaints concerning financial advisors present the greatest risk of consumers not being paid their compensation awards. This was referred to in the Richard St. John report and the Australian Bankers' Association noted in their submission to the Issues Paper that some consumers suffer losses because of inappropriate advice and where a financial adviser or product issuer has not maintained adequate compensation arrangements.[22]

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[17] Report by Richard St. John, *Compensation arrangements for consumer of financial services*, April 2012
[18] Statutory Compensation Review: Future of Financial Advice, Letter from Richard St. John to The Hon Bill Shorten MP, 5 April 2012
[19] Interim Report, p 166
[20] Interim Report, p165
[21] ASIC Regulatory Guide 126, *Compensation and insurance arrangements for AFS licensees*, *Scope of cover*, p 17
[22] Australian Bankers Association, Submission to the EDR Issues Paper, October 2016, p 6

To tackle this matter, more must be done to improve the quality of financial advice and the consumer protection arrangements in place for this sector. In this regard, we agree with the Australian Bankers' Association's call for a greater professionalisation of financial advice and, as we have noted above, we suggest there be an ongoing assessment of ASIC's scrutiny of PI insurance across the financial planning industry.

With regards to their suggestion that the coverage of PI insurance should include run-off cover, insolvency and fraud, the ICA has previously discussed the possibility of a group 'gap' scheme involving licensees from a particular financial services sector. While theoretically possible, the appetite of the private sector to provide such cover at a level of premium that would be affordable is uncertain and an industry body or regulator would be needed to 'own' the scheme and administer it.

A key concern for the ICA in considering the question of a last resort compensation scheme is the moral hazard that would result from removing all risk from financial decision making. This concern was also expressed in the report by Richard St. John who noted that a last resort compensation scheme would not address the underlying problem of improving the standards of licensee behaviour or motivate a greater acceptance by them of responsibility for the consequences of their own conduct.[23]

To conclude, the ICA does not support a compensation scheme of last resort that would facilitate cross-subsidisation of compensation costs by groups unrelated to the consumer's financial loss. In the first instance, priority should be given to bolstering the regulatory framework for financial advisers and other licensees. Then, if deemed necessary, detailed consideration of the design of a last resort compensation scheme will be needed to address the legitimate concerns of moral hazard and inequity that a compulsory industry-funded scheme raises.

[23] Report by Richard St John, p 10