INSURANCE COUNCIL OF AUSTRALIA

12 April 2019

Manager
Insurance and Financial Services Unit
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Sir/Madam

INSURANCE CLAIMS HANDLING CONSULTATION PAPER

The Insurance Council of Australia (Insurance Council) endorses action to implement recommendation 4.8 of the Financial Services Royal Commission's (FSRC) Final Report relating to the removal of the claims handling exemption from the definition of 'financial service'. As noted by the Commissioner, the need for this reform was demonstrated through a number of case studies that highlighted the limits to the regulatory interventions on claims handling conduct that the Australian Securities and Investments Commission (ASIC) can make.

In its review of life insurance claims[1], ASIC noted that the claims handling exemption limited its ability to take action for conduct such as:

- incentives for claims handling staff and management, including whether they are in conflict with the insurer's obligation to assess each claim on its merit;
- surveillance practices by investigators, particularly for mental health claims; and
- unnecessary or extensive delays in handling claims.

In the FSRC's Final Report, the Commissioner also expressed the view that insurance claims should be handled "efficiently, honestly and fairly". The Insurance Council and its members support the Commissioner's view, and we also support reforms to allow ASIC to take appropriate action in relation to poor claims handling practices.

In particular, we support the use of existing legislative powers to define the activity of handling or settling an insurance claim as a specific 'financial service' for the purposes of the *Corporations Act 2001*. However, the details of that approach need to focus on addressing the regulatory gaps identified by the FSRC, namely the requirement to act efficiently, honestly and fairly, and the inability of ASIC to seek improvements in claims handling processes. In addressing these gaps, care needs to be taken to avoid inappropriately applying the obligations under chapter 7 of the *Corporations Act 2001* to claims handling processes.

[1] ASIC (2017) Report 498 *Life Insurance Claims: An Industry Review*

Insurance Council of Australia Limited ABN 50 005 617 318
PO Box R1832 Royal Exchange NSW Australia 1225
t +61 2 9253 5100 f +61 2 9253 5111
www.insurancecouncil.com.au

As noted in the consultation paper:

> "… some requirements could be difficult to apply or could impose a heavy compliance burden on either insurers or third parties who may be involved in insurance claims handling, the cost of which would ultimately fall on consumers but without providing significant benefits to them" (p9).

In particular, the rationale for establishment of the claims handling exemption in the first place needs to be addressed as part of the proposed changes. Firstly, the exemption allows insurers to have discussions with insureds during the claims process without triggering the financial advice rules. For example, the personal advice rules may be triggered by discussions between claims management staff and the insured around whether to lodge a claim given the potential quantum of a claim and the applicable excess. Applying the financial advice regime to claims handling would make existing processes more costly, without any anticipated benefits for consumers. Secondly, the exemption takes into account the broad range of parties that play a role in the claims management chain, some of whom it would be impractical to capture within the financial services licensing framework. We provide further details on both points below.

We also note the significant reform agenda underway, including the proposed extension of unfair contract terms protections to insurance contracts, the product design and distribution obligations and product intervention powers, and proposals relating to the enforceability of the General Insurance Code of Practice (GICOP). As a matter of principle, the Insurance Council believes these reforms and any GICOP requirements relating to claims handling should be harmonised with Treasury's claims handling proposals to avoid overlapping, inconsistent requirements that add to cost and complexity.

The current exemption for financial advice and dealing should remain

The removal of the claims handling exemption would trigger the application to AFS licensees of a number of requirements under the Corporations Act and claims handling staff may be inadvertently deemed to be providing personal financial advice to customers in the ordinary course of handling an insurance claim. This would impact the ability of insurers to have discussions with, and provide guidance to, insureds during the claims process (see attachment B for examples).

Treasury suggests that one option to address this issue is to specify in regulations that certain documents and statements that are provided to a consumer as part of the new financial service do not constitute financial product advice.[2]

While this option would go some way to addressing the issue, it remains limited to specific, prescribed statements and documents. Compliance with such a provision is likely to focus training for employees on phrasing information so as to allow them to remain within the scope of the prescribed statements and documents, rather than on delivering information that is of the most assistance to the consumer's inquiry. In addition, if prescribed statements and documents could only be issued by certain licensed staff, then this could create a specialist bottleneck that results in service delays.

[2] Relying on subsections 766B(1A) and 766B(9) of the *Corporations Act 2001*.

The Insurance Council submits that a better approach would be to retain the current exemption for advice. A possible option to achieve this is for regulation 7.1.33(1) to be retained (the advice limb of the exception) [for reference, regulation 7.1.33 is included in attachment A of this submission]. Alternatively, the effect of 7.1.33(1) could be replicated in the legislative definition of the new financial service.

Similarly, the Insurance Council also supports the retention of the current exemption for dealing (as set out in regulation 7.1.33(2)) so that the obligations that Treasury expressed concern about do not apply to the process of disposing a contract during the claims handling process.

How could the activity of handling or settling an insurance claim be defined as a financial service for the purposes of the Corporations Act?

Treasury suggests that the activity of handling or settling an insurance claim as a 'financial service' could be defined to include ways in which insurers:

- make a decision about a claim, including investigating claims and interpreting policy provisions;
- conduct negotiations in respect of settlement amounts;
- prepare estimates of loss or damage, or likely repair costs; and
- make recommendations about mitigation of loss (p10).

In our view, this definition is too wide and fails to take into account the broad range of parties that play a role in the claims management chain.

Instead, the definition of claims handling should be targeted specifically around the decision making elements of the claims management chain that were identified as regulatory gaps in the Financial Services Royal Commission. The definition should not include activities related to the fulfilment of the claim.

An application of claims handling as a financial service to the fulfilment supply chain will only add to the cost of compliance and procurement for insurers. This will, inevitably, impact on insurance premiums without any appreciable benefit to consumers and may also lead to a lessening of services and options provided by insurers due to these additional costs.

For example, the obligations under part 7.6 of the Corporations Act include training, administration and supervision arrangements. Suppliers engaged for the purpose of claims fulfilment (builders, restorers, smash repairers - many of whom are small businesses), may withdraw their services if they become subject to these obligations, leading to a reduction in competition.

Further, insurers often operate in regional areas and in response to catastrophes – circumstances in which insurers already face significant logistical and practical difficulties in handling and settling claims. If suppliers withdraw their services in these circumstances, insurers may be forced to cash settle and transfer the repair risk to the consumer.

The Insurance Council's discussions with its members have highlighted a range of operating models and significant complexity in defining claims handling as a financial service given the multi-step nature of a claims lifecycle. We would welcome an opportunity to meet with

Treasury to provide a further, detailed analysis of the life-cycle of a claim and an overview of the extent of supply chains utilised by insurers.

Separately, Treasury notes that one option to mitigate the impact of the licensing requirements is "restricting the financial service to where a person is acting on behalf of an insurer (or an intermediary acting on behalf of an insurer). This means that certain persons who contribute to assessments, such as medical practitioners, are unlikely to be acting in the capacity of a representative of the insurer" (p13). The Insurance Council suggests that this option would help in defining the appropriate scope of an insurer's responsibility for claims handling conduct.

We also think consideration should be given to how complaints made by insureds about a claims handling activity are dealt with. There should be consistency between any revision to the Act and Regulations with the existing mechanisms under GICOP and ASIC Regulatory Guide 165.

We also understand that the proposed claims handling obligations would apply to insurance brokers given the activities that they undertake.

Application to retail clients

As noted in the consultation paper, the issues identified by the FSRC and ASIC on the handling and settling of insurance claims have overwhelmingly related to retail clients as defined for general insurance in the Corporations Act. Consistent with the regulatory framework within the Corporations Act, the Insurance Council supports limiting the definition of claims handling activity to services provided to retail clients (s761G). Other services, where issues have been identified, could also be brought into the scope of the definition.

Under regulation 7.1.17A of the *Corporations Regulations 2001*, the definition of a retail general insurance product extends to medical indemnity insurance. However, this was instituted in a particular context following reforms to stabilise the medical indemnity insurance market. All other professional indemnity products, including those provided to other healthcare practitioners such as dentists and optometrists, are not defined similarly as retail products. As such, medical indemnity insurance should be exempted from the proposed definition of claims handling activity.

Statutory classes of insurance

Statutory classes of insurance (such as workers compensation and compulsory third party (CTP) insurance) should not be within scope of the proposed claims handling regime given the substantial regulatory protections that already exist within their own particular regimes.

Similarly, strata insurance given the nature of this product as a state based statutory commercial product should also be exempted from the proposed definition of claims handling as a financial service. This would be consistent with the various state based strata legislation which typically include an exemption under section 5F of the Corporations Act.

Third parties

One question which needs to be addressed is the scope of to whom an AFSL holder undertaking claims handling owes its obligations under section 912A of the Corporations Act. The Insurance Council believes that third parties should not be captured within the proposed regime. The Insurance Council would also welcome clarity on the application of the

proposed regime to third-party beneficiaries given section 48 of the *Insurance Contracts Act 1984*.

For example, under professional indemnity and public liability policies the insurer has a contractual arrangement with and acts on behalf of the insured. It would be inappropriate for an insurer to be subject to the section 912A obligations in the course of handling a third party claim against its insured or when recovering from at-fault parties.

Other issues

Cross-endorsement

Under section 916C of the Corporations Act:

(1) One person can be the authorised representative of 2 or more financial services licensees, but only if:

(a) each of those licensees has consented to the person also being the authorised representative of each of the other licensees; or

(b) each of those licensees is a related body corporate of each of the other licensees.

In practice, suppliers may work with several insurers and if they become authorised representatives under the proposed regime then each licensed insurer would need to provide consent. This would be impractical to implement and may lead to a reduction in the availability of claims handling services for consumers.

Interaction with General Insurance Code of Practice

As Treasury is aware, the Insurance Council and its members are currently revising the GICOP and considering the FSRC's recommendation in relation to the enforceability of industry codes. As mentioned above, the Insurance Council and its members believe that, as a matter of principle, Treasury's proposed reform and any GICOP requirements relating to claims handling should be harmonised to avoid overlapping, inconsistent requirements that add to cost and complexity.

Transition

The Insurance Council and its members would welcome additional clarity on the mechanisms for bringing the proposed reforms into the existing AFSL licensing regime. For example:

- What would an insurer be required to demonstrate in order to have the new financial service added to an existing AFSL?;
- Would AFSL holders be expected to nominate a responsible manager to the licence specifically for claims handling activities, and will there be guidance on the experience and educational qualifications that such managers will be required to demonstrate?; and
- Will existing claims services be allowed to continue to be used during the approval process?

In view of the significant impact of the proposed reform, we would welcome an industry roundtable with Treasury on these issues. We also recommend that there be a transition period of 24 months.

Penalties

The current penalties which apply to breaches of section 912A are very substantial following the recent introduction of the *Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Act 2019.* The Insurance Council does not see a need for specific penalties to be developed for breaches in relation to claims handling.

It is also important in determining whether breaches have occurred and applying penalties, that due consideration is given to the context in which insurers operate. In particular, during a catastrophe while striving to meet the needs of their policyholders, insurer resources are often strained and there may be logistical and practical difficulties in handling and settling insurance claims.

If you have any questions or comments in relation to our submission, please contact John Anning, the Insurance Council's General Manager Policy, Regulation Directorate, on (02) 9253 5121 or janning@insurancecouncil.com.au.

Yours sincerely

Robert Whelan
Executive Director and CEO

INSURANCE COUNCIL OF AUSTRALIA

ATTACHMENT A

CORPORATIONS REGULATIONS 2001

7.1.33 Handling insurance claims

(1) For paragraph 766A(2)(b) of the Act, a circumstance in which a person is taken not to provide a financial service within the meaning of paragraph 766A(1)(a) of the Act is the giving of advice that consists only of a recommendation or statement of opinion provided in the course of, and as a necessary or incidental part of, either or both of:

(a) the handling of claims or potential claims in relation to an insurance product; and

(b) the settlement of claims or potential claims in relation to an insurance product.

(2) For paragraph 766A(2)(b) of the Act, a circumstance in which a person is taken not to provide a financial service within the meaning of paragraph 766A(1)(b) of the Act is a dealing in an insurance product that is a necessary or incidental part of either or both of:

(a) the handling of claims or potential claims in relation to that product; and

(b) the settlement of claims or potential claims in relation to that product.

Examples of services:

1 Negotiations on settlement amounts.

2 Interpretation of relevant policy provisions.

3 Estimates of loss or damage.

4 Estimate of value or appropriate repair.

5 Recommendations on mitigation of loss.

6 Recommendations, in the course of handling a claim as described in subregulations (1) and (2), on increases in limits or different cover options to protect against the same loss in the future.

7 Claims strategy such as the making of claims under alternate policies.

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ATTACHMENT B

EXAMPLES OF THE PROVISION OF FACTUAL INFORMATION

Though many situations in the claims handling process involve the provision of factual information, the removal of the insurance claims handling exemption may mean these situations are seen as financial advice because of the wide definitions used in the Corporations Act. For example:

- In the context of make safe work, the customer may ask how to prevent the damage getting worse. They have the option to appoint a builder/restorer/roof tiler to review the damage and make recommendations on make safe before a claim is lodged.

  Alternatively, following lodgement the insurer may appoint a supplier if the customer agrees to use an insurer's panel repairer, or the customer may choose to go with their own repairer. Further, specific mitigation advice is generally provided by the repairer rather than the insurer (e.g. tarpaulin, replace tiles, dry out water damage), whether appointed by the customer or the insurer.

- In a scenario where there has been a house fire, the customer may ask whether they should rebuild or cash settle. The insurer presents the options to the customer so they can consider whether they want to rebuild and either continue to live there or sell, or given the insurer clears the land, the customer could cash settle and sell the land. In this situation, the insurer presents factual information rather than financial advice and the customer makes the decision on how they want to proceed based on their individual circumstances and without influence from the insurer.

- In the scenario where there is vehicle total loss, the customer faces the question of whether to replace the vehicle or cash settle. The insurer will present the options to the customer – the insurer can arrange for a replacement vehicle to the same specifications as the destroyed car in accordance with the policy, or the customer may opt to cash settle (for example to upgrade their car or not buy a car). In these situations, factual information is presented by the insurer and the customer makes the decision on how they want to proceed based on their individual circumstances. The insurer doesn't influence the customer's decision.