

Royal Commission Response | Claims as a financial service

Claims as a financial service

The recommendation to regulate claims handling as a 'financial service' impacts both general insurance and life insurance, although this analysis is limited to general insurance.

The change may be more far-reaching in its impact for the general insurance industry than initially thought.

A government response could be quick

The government announced in February that it would move quickly on this recommendation. Treasury issued a consultation paper on 1 March seeking submissions by 29 March on how to implement this change.

It remains possible that we could see the outcome of consultation and draft legislation before the Federal election.

What is the goal of the recommendation?

Commissioner Hayne recommended that insurers should have a duty to handle claims '**efficiently, honestly and fairly**'. This is one of the core obligations imposed on AFS License holders. Because of the claims handling exemption, ASIC has had no jurisdiction to investigate unfair claims practices by insurers and third party administrators, which was raised as an issue in previous life insurance reviews. There were several case studies examined during the Royal Commission involving life insurance claims, as well as four cases of general insurance claims following natural disasters.

The goal is to apply the '**efficiently, honestly and fairly**' obligation to claims handling and to give ASIC relevant regulatory authority to investigate and prosecute instances where this obligation is not met.

This goal can be met with modest changes to rules and practices, or it can be met with extensive changes and the consequent additional costs. This theme is explored throughout our analysis.

A best case outcome

The least disruptive and costly way of implementing the recommendation might be to:

- a. Remove Regulation 7.1.33 which states that claims handling is not a financial service for the purpose of the Act. This brings in the overarching requirement to provide financial services 'efficiently, honestly and fairly'
- b. Apply the AFSL requirements only to those with decision making authority over claims – such as insurers, third party claim managers and underwriting agents with claims authority and not regulate service providers such as loss assessors, adjusters and investigators.
- c. Limit the licensing requirement to those providers who deal with retail clients. The licensees are responsible for the activities of their service providers.
- d. Build the expectations regarding 'efficient, fair and honest' into the enforceable provisions within the General Insurance Code of Practice with AFCA responsible for first line supervision, leaving ASIC to intervene where there are significant breaches and systemic problems, by taking enforcement action (eg legal proceedings and penalties).

Unanswered questions

The 'best case outcome' outlined above makes assumptions regarding questions that are still unanswered including:

- How is 'claims handling' defined as a financial service in the Act?
- Would the requirements apply to 'retail clients', or a broader range of products, for example those insureds and products that are within AFCA's remit, including small business property risk?
- Would the obligations and AFSL requirements apply beyond the claim decision makers – to adjusters, investigators, inspectors, builders, medical experts, repairers?
- Which specific obligations will apply to claims handling – compliance systems, disclosure documents, resourcing, competence, conflicts of interest, training and the like?
- Will claims managers and officers now have to act differently with this new statutory duty to handle claims efficiently, honestly and fairly?

Defining the 'claims handling' activity

Treasury's consultation paper suggests that the definition of 'financial service' in the Act may need to be expanded to clarify what is a claims handling activity.

The current exclusion in the Corporations Regulations specifies that the handling and settlement of claims is neither giving advice nor dealing in an insurance product. It gives specific examples: negotiations on settlement amounts,

- interpretation of relevant policy provisions,
- estimates of loss or damage,
- estimate of value or appropriate repair,
- recommendations on mitigation of loss,
- recommendation to increase limits or consider different cover options to protect against the same losses, and
- claims strategies such as the making of claims under alternate policies.

These examples of what is currently not a financial service do not make a suitable definition of what constitutes claims handling when it is to be treated as a financial service. It may be that just the statement "handling or settlement of claims or potential claims" may be quite adequate as a definition. .

Retail Clients/Products or All Products?

As retail clients may be the most vulnerable to unethical or unfair claims decisions, there is a case for the requirement to be licensed for claims handling to be confined to retail clients/products. This would include products and clients as follows:

- Motor, home building, home contents, sickness & accident, consumer credit, travel and domestic & personal property insurance, and
- Where the policyholder is an individual or small business (up to 20 employees, or 100 if in manufacturing).

It seems unlikely, for example, that insureds holding a medical indemnity insurance product would need to be protected but this is unclear. Consumer groups may want claims handling to be regulated when dealing with some business insurance products such as fire or burglary (in line with the terms of reference for external dispute resolution by AFCA).

The requirements should not apply to motor injury insurance (CTP) or workers compensation even when these are underwritten by private insurers.

Who would the obligations apply to?

Most insurers hold an AFSL if they deal with retail clients and it is likely that they would vary their AFSL to include claim handling activities.

A third party claims administrator could manage the requirements to be licensed in one of two ways – obtaining its own AFSL or becoming an Authorised Representative of one or more insurers.

Insurance underwriting agencies (or MGAs) operating under a binder with claims handling authority that already have an AFSL are likely to vary their licence to include claims handling activities. If the regulations apply only to retail clients, this will result in consistent regulatory treatment as underwriting agencies are not required to hold an AFSL if they are acting on behalf of an APRA-regulated insurer and dealing only with wholesale clients.

Many have asked about whether service providers should be included – loss adjusters, investigators, builders, forensic accountants, medical experts, engineers, and the list goes on.

Our view is that there is no benefit in bringing any of these groups specifically under the ASIC regulatory umbrella just for their outsourced services in relation to claim handling activities. The law already makes the licensee (in this case the insurer, TPA or underwriting agency) responsible for activities undertaken on its behalf by others and we think taking this approach will keep additional compliance costs to a minimum without any detriment to consumer outcomes.

What further obligations would apply?

The Act has a long list of obligations that need to be met by an AFSL holder (and their representatives) in addition to the core 'efficiently, honestly and fairly' provision.

These include:

- Management of conflicts of interest – this could be difficult to deal with, e.g.
 - If a claims officer suspects fraud, does the insurer have to disclose this to the claimant and when?
 - Staff KPIs that may be perceived to compromise the ability to manage claims 'fairly'
- Comply with the financial services laws and licence conditions
- Have adequate resources to carry out and supervise activities – this could be particularly challenging when managing claims arising from cat events
- Maintain competence
- Ensure adequate training of staff and authorised representatives
- Have internal and external dispute resolution systems
- Have adequate risk management systems.

This is where a great deal of additional compliance costs could arise if all of these obligations apply to regulated claims service providers. For sales and advice businesses ASIC issues regulatory guidance and requires systems to be in place to demonstrate and monitor compliance. It is those systems that can create significant cost.

A good case could be made to not apply these more specific obligations to claims handling and instead include more specific requirements for claims handling activities in the General Insurance Code of Practice (as these provisions will be mandatory and legally enforceable under another Royal Commission Recommendation).

Is there 'advice' in claims handling?

Some of the other questions that have arisen based on extending the currently sales and advice rules are: Will there be new disclosure requirements (akin to FSG or PDS)?

- Is there a need for a 'general advice' warning?
- Would any claims handling activities constitute 'personal advice' and how should this be regulated?

- If a product terminates as a result of a claim (e.g. a total loss) does that constitute 'disposal' of the financial product?
- Would suggestions made about alternative products following claims constitute 'financial advice'?

In our view it would be wrong to assume that all the obligations relevant to advice and sales would also be relevant for claims.

As an example the current law says that estimating the value of goods to be insured is not a financial service. Estimates of repair cost and values would arguably warrant the same treatment.

Finity's view

The cost and disruption to the general insurance sector could be a little or a lot depending on how the law is changed, how ASIC rules and guidance are developed and then how they are applied and supervised in practice.

Insurers in the retail market will need to:

- Take a view on whether claims costs are likely to increase
- Factor in additional compliance expenses
- Make a commercial decision on whether to change premium rates
- Develop early warning indicators of changes in claims experience in order to respond quickly

The Treasury consultation paper brings out the question of benefits versus costs. The consultation process, **closing on 29 March**, may be the last opportunity to put forward proposals (such as we outlined in our best case outcome) to achieve the desired objectives at an acceptable cost.

The Fold's view

There will be opportunities for consumer action groups and ASIC to hold insurers more accountable if they do not change claims handling practices. This could spell the end of current practices like cash settlements following a natural disaster. A focus on protecting the most vulnerable insurance consumers is likely to prevail to temper the increased compliance and regulatory costs.

The transition to claims handling as a regulated financial service will be clearer for all industry participants after the end of the Treasury consultation process and once draft legislation is released. ASIC will also release regulatory guides and other policy guidance for claims handling services.

Anyone seeking an AFSL or to vary their existing AFSL will need to be able to demonstrate their previous experience in claims handling. At this time, it is unclear how ASIC will handle the licensing process and whether some applicants will be able to streamline their application if they already have an AFSL and have provided exempt services previously. ASIC will probably impose training requirements within ASIC Regulatory Guide 146 (RG146) but we expect it will give the industry time to comply with them (as it has done in the past).

This update was prepared in collaboration with The Fold



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