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The Hayne Royal Commission's impact on insurers in 2021

Claims as a financial service and enforceable code provisions

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AT A GLANCE

- A year after the Royal Commission report was submitted, claims handling has emerged as one of the biggest issues for the insurance industry.
- The *Financial Sector Reform (Hayne Royal Commission Response) Act* 2020 (the Act) was given assent on 17 December 2020. Schedule 4 of the Act which has the effect of making handling and settling a claim a financial service under the *Corporations Act* 2001 (Corporations Act) will commence on 1 January 2021.
- Insurers now face higher compliance costs and a more assertive regulator.

The Royal Commission made the following **two key recommendations** concerning claims handling:

1. The "*handling and settlement of insurance claims, or potential insurance claims, should no longer be excluded from the definition of 'financial service'*" (**Recommendation 4.8**)

2. By 30 June 2021, certain provisions (yet to be identified) in the Life Insurance Code of Practice, the Insurance in Superannuation Voluntary Code and the General Insurance Code of Practice are to be made enforceable code provisions (**Recommendation 4.9**).

The Act has been passed to put these recommendations into effect.

NEW OBLIGATIONS

The scope of the new financial service

The Act creates a new 'financial service' of handling and settling a claim under an insurance product. A person provides a "*claims handling and settling service*" if they:

- make a recommendation, or state an opinion
  - in response to an inquiry about a claim or potential claim, or
  - that could influence a decision on whether to make or continue with a claim
- assist an insured to make a claim
- assess whether an insurer has a liability under an insurance product
- decide to accept or reject all or part of a claim under an insurance product
- quantify the extent of the insurer's liability under an insurance product
- offer to settle all or part of a claim under an insurance product, or
- satisfy a liability of an insurer under an insurance product in settlement of a claim.

Licensing requirements

The Act requires the following entities to either hold an Australian Financial Services Licence (AFSL) or be an authorised representative of such a licence holder if they provide a claims handling and settling service:

- insurers
- third party claims administrators
- "insurance fulfillment providers" (such as a smash repairer or building contractor given authority by an insurer to accept or reject claims)
- brokers and financial advisers who handle claims on behalf of insurers, and
- "claimant intermediaries" (those that represent people to pursue insurance claims for reward).

Insurers with existing AFSLs will need to have their licences extended to cover claims handling and settling. Insurance fulfilment and other service providers can operate under insurers' AFSLs and need not obtain their own AFSL. They do not need to be formally appointed as authorised representatives.

A superannuation trustee with the benefit of a registrable superannuation entity (RSE) licence does not require an additional AFSL as the RSE licence covers all conduct associated with operating a superannuation fund, including claims handling.

Entities only need to apply for the elements of a claims handling and settling service that apply to them (e.g. a company that manages, on behalf of an insurer, inbound calls about lodging claims, may only need an AFSL that authorises it to respond to inquiries about a potential claim and help a person make a claim).

An insurer does not require an AFSL if its claims handling and settling services are provided by an intermediary that holds the required AFSL.

It is expected that the following will generally not require an AFSL:

- loss adjustors
- experts such as doctors, engineers and forensic accountants[1]
- investigators, and
- "insurance fulfillment providers" (such as a smash repairer or building contractor who are not authority by an insurer to accept or reject claims).

Certain services provided by a lawyer are specifically excluded from "claims handling and settling", including providing legal advice, investigating the insurer's liability, and negotiating the settlement of a claim.

Cash settlement fact sheet

The legislation requires insurers to give a cash settlement fact sheet to retail clients if they are offering to settle a general insurance claim via a cash settlement, rather than offering to repair or replace a product.

This seems to be aimed at addressing the Royal Commission's criticism of insurers that offered cash settlements to insureds for property claims based on the lowest quote obtained by an insurer. Counsel Assisting suggested the insurers had the benefit of volume discounts that may not be available to the individual policyholder.

[1] Giving a recommendation or opinion (or a report of either of those things) that is reasonably necessary as part of handling and settling an insurance claim is not providing financial product advice (section 766B(7A)).

Enforceable code provisions

The Act provides that certain provisions of financial services industry codes be made 'enforceable code provisions', which will be agreed between ASIC and the applicant. The Explanatory Memorandum states that it is expected that specific commitments made by a code subscriber to the consumer, which if breached are likely to result in significant and direct detriment to the consumer, will be made enforceable.

Examples provided are:

- cooling off periods
- providing information to consumers, and
- fees and charges.

The Explanatory Memorandum states that provisions that are broader in their nature and seek to make general, in-principle commitments regarding industry practices or aspirational targets, would not meet the requirement for enforceable code provisions.

The Act allows the government to impose a mandatory code of conduct where efforts between ASIC and industry to develop a voluntary code of conduct have not been successful.

Timing

ASIC expects to start taking applications for AFSLs, and variations to existing licences, from 1 January 2021.

During the transition period between 1 July 2021 and 31 December 2021, claims handing and settling services can only be provided if a complete application was lodged by 30 June 2021, and it has either been granted or is still pending. From 1 January 2022 claims handling and settling services can only be provided if the application has been granted.

The new AFSL obligations will apply to persons providing claims handling and settling services regarding any insurance claim made on or after 1 January 2021 that is still on foot when the transition period ends. This applies regardless of when the insurance contract commenced.

IMPACT ON INSURERS

The legislation will make claims handling and settling subject to the general obligations under section 912A of the Corporations Act including to:

- do all things necessary to ensure that the financial services are provided "efficiently, honestly and fairly", and
- ensure that its representatives are adequately trained and are competent.

The Explanatory Memorandum / ASIC Guidance indicates that this will require:

- the timely settlement of claims
- minimising onerous and intrusive investigations to those strictly relevant to the claim
- providing information to the insured about the handling and settling process, the reasons for information requests and the reasons for decisions provided to the insureds, and
- providing adequate support to insureds, particularly vulnerable customers.

The Explanatory Memorandum also indicates that an insurer will be in breach of its general obligations if it continues to engage service providers that have had complaints made about them.

ASIC guidance states that "critically" insurers' internal dispute resolution procedures must be independent of their other operations including, claims handling, underwriting and sales.

> **The legislation will make claims handling and settling subject to the general obligations under section 912A of the Corporations Act**

EXAMPLES:

Timely settlements

An example given of acting contrary to this requirement is a claims manager failing to return an insured's phone calls and then going on holiday without appointing a new manager. The Explanatory Memorandum indicates that an insurer will be held responsible for delays by its authorised representatives.

ASIC states that the timeframes for handling claims set out in industry codes are useful indicators of what industry considers to be appropriate standards.

Investigations

An example given of acting contrary to the requirement to minimise onerous and intrusive investigations to those strictly relevant to the claim is requesting reports from three orthopaedic surgeons rather than just one. ASIC states:

- requests for information or attendance for a medical examination should only be made if strictly relevant to the claim
- it is not acceptable to issue a standard template request with a long list of requirements to all claimants
- surveillance and other intrusive assessments should only be undertaken in exceptional circumstances (e.g. a reasonable suspicion of misrepresentation or fraud)

Adequate support to insureds

An example given of acting contrary to this requirement is failing to reschedule a medical appointment for an insured to a date on which the insured's husband can assist her to attend the appointment when the insurer is aware that the insured could not attend the appointment without assistance from her husband.

ASIC states that the insurance industry codes provide useful indicators of what industry considers to be appropriate strategies for dealing with consumers experiencing vulnerability.

While in theory the duty of utmost good faith and the duty to act efficiently, honestly and fairly may be synonymous, the purpose of the recommendations is to give ASIC and AFCA proper oversight over how claims are handled.

To enhance AFCA's oversight, the Commissioner recommended that section 912A of the Corporations Act be amended to require that AFSL holders take reasonable steps to cooperate with AFCA in its resolution of a particular dispute, including, in particular, by making available to AFCA all relevant documents and records relating to issues in dispute (Recommendation 4.11).

ASIC will also be under an obligation to do audits of insurer's claims files to ensure compliance with section 192A and insurer's self-reporting obligations regarding breaches.

Insurers need to ensure that they are exercising these obligations appropriately and keeping appropriate records. The conduct of one retail insurer in failing to keep proper records of its claims handling process was criticised by the Commissioner as having the potential to undermine the effectiveness of external dispute resolution schemes.[2]

Investigations costs, fines and penalties cover will also take on increased significance given the combination of ASIC's enforcement philosophy and the increased penalties under the *Treasury Laws Amendments (Strengthening Corporate and Financial Sector Penalties) Act 2019*.

[2] Final Report, Volume 2, page 431.

Training and performance management

Section 912A also requires AFSL holders to ensure that its representatives are adequately trained and are competent, to provide the financial services provided under their licence.

As a matter of practicality, insurers may choose to develop and provide further training to claims officers in advance of any changes, so that they are made aware of their potential record keeping and breach reporting obligations.

Insurers may also want to examine the performance management system under which their claims examiners and service providers operate. The Treasury has identified that claims teams having KPIs relating to the time in which claims should be resolved, irrespective of the claims outcome, could mean that the insurers' potential for managing conflicts of interest are inadequate.[3] The KPIs for the claims team of one retail insurer were specifically criticised by the Commissioner as emphasising the handling of new claims at the expense of dealing with existing claims.[4] Appropriate management of conflicts generally was a primary concern of the Royal Commission and has been identified by the Commonwealth Government as an issue to be addressed. Insurers may wish to review their conflict management systems generally.

ASIC's guidance on this issue states that examples of arrangements that could result in a conflict of interest are:

- an insurer linking the remuneration of staff to the level of accepted, declined or withdrawn claims, or to staff keeping total payouts for accepted claims below certain financial targets
- a life insurer having 'early intervention' programs that are structured in a way that might effectively dissuade a person from lodging a claim, and
- an insurer offering rebates or other benefits to the policyholder of a group insurance policy if claims received under the group policy do not exceed agreed benchmarks.

ASIC expects claims handling managers to have at least three years' relevant experience in handling and settling insurance claims over the past five-year period, and:

- a university degree in business, law, commerce or finance, or another relevant degree, or
- a qualification equivalent to a diploma (or higher) from a relevant professional body.

THE CONCERN FOR INDUSTRY

Insurers will need to undertake a review of all their agreements with relevant service providers to impose requirements for the provision of timely and competent services. They will also need to ensure that their service providers either obtain the necessary AFSL or reach agreement for the service providers to be authorised representatives of the insurers.

With greater review and enforcement of the standards, we will see a greater requirement of transparency in the determination of claims. Arguably, negotiations will have to be at the level the claim is worth (no low-ball offers), with an obligation to negotiate with full transparency (including disclosure of third party reports). This will now be subject to regulatory, review, audit and prosecution (for any failings), extending beyond retail first party insurance.

Claims handling cannot be treated as an adversarial arm's length process[5]. It now needs to be treated as a core service offering by insurers to insureds, in which the insured's interests are to be treated as equal to the insurer's interests.

The imbalance of power between the insurer and the insured is to be adjusted by the introduction of independent referees (ASIC and AFCA) with far reaching powers, increased funding and a mandate from the Royal Commission and the government to proactively enforce insurers' obligations.

[3] Insurance Claims Handling Consultation Paper, page 7.
[4] Final Report, Volume 2, page 428.
[5] As an example, the Commission criticised CBA for "making inappropriate challenges" to FOS's jurisdiction and failing to provide information requested by FOS and TAL for failing to engage with FOS in a frank and cooperative way.

Need to know more?

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