INSURANCE COUNCIL OF AUSTRALIA

Manager
Financial Services Unit
The Treasury
Langton Crescent
PARKES ACT 2600

Submitted by email: EDR@treasury.gov.au

14 June 2017

Dear Sir/Madam

Improving dispute resolution in the financial system

The Insurance Council of Australia (ICA) welcomes the opportunity to provide feedback on the Improving dispute resolution in the financial system consultation paper (Consultation Paper).

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 general insurers. ICA members, both insurers and reinsurers, are a significant part of the financial services system.

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 ICA and our members firmly support the existence of a robust and effective external dispute resolution (EDR) scheme. EDR provides an independent and accessible mechanism for consumers who are unable to resolve their complaint with a financial service provider.

In this regard, we support the establishment of the new Australian Financial Complaints Authority (AFCA). We are pleased that the structure proposed is based on an industry ombudsman model. AFCA has the potential to capitalise on the advantages of ombudsman schemes while offering a streamlined service to consumers.

Notwithstanding these prospects, the ICA would like to highlight the following key matters which we believe should be considered as the structure and operation of AFCA is worked through.

Firstly, as far as possible, AFCA must be established with minimal confusion to consumers and disruption to industry. This will require a practical approach that utilises existing processes, systems, infrastructure and expertise.

Secondly, AFCA's governance framework must foster effective engagement with stakeholders, while maintaining independence. We would like to see an embedded requirement for stakeholder consultation before significant changes can be introduced to AFCA's operations or terms of reference. The engagement by the Financial Ombudsman Service (FOS) with both industry and consumer representatives has been one of the strengths of the scheme.

Lastly, the ICA does not support the introduction of revised claim limits and compensation caps that include:

- A $1 million limit on the size of non-superannuation consumer disputes;
- A minimum $500,000 compensation cap for non-superannuation consumer disputes; and
- A possible $1 million compensation cap for certain products such as mortgages and general insurance.

As we advise later in the submission, we believe that such increases will have a sizeable impact on the affordability and availability of professional indemnity insurance (PI insurance). Additionally, there will be ramifications for the general insurance industry more broadly. Increased uncertainty around Ombudsman decision-making will have to be factored into premium pricing. We note that superannuation disputes will have to be determined in accordance with the law and will be subject to appeal. We suggest that these provisions are extended to all disputes.

We have provided further detail on these matters below. We have restricted our comments to those questions that pertain to the general insurance industry.

The ICA looks forward to working closely with Treasury and all stakeholders as the specifics of AFCA are developed. We are keen to ensure that an enhanced dispute resolution process is in place for consumers.

If you would like to discuss any of the issues covered in this submission, please contact Sarah Phillips, Acting General Manager Consumer Relations & Market Development on 02 9253 5120 or sphillips@insurancecouncil.com.au

Yours sincerely

Robert Whelan
Executive Director and CEO

Question 2

Do you consider that the Bill strikes the right balance between setting the new EDR scheme's objectives in the legislation whilst leaving the operation of the scheme to the terms of reference?

And

Question 3

Are there any issues that are currently in the Bill that would be more appropriately placed in the terms of reference or issues that are currently absent from the Bill that should be included in the Bill?

The ICA supports having the high-level objectives of the scheme in the governing legislation, with the terms of reference providing the more detailed operational requirements. We have found value in the existing arrangement with FOS, whereby the terms of reference set out FOS rules and processes and can be amended following stakeholder consultation and Board approval.

It is currently unclear whether AFCA's terms of reference will be provided to stakeholders for consultation. To ensure the scheme commences in a constructive fashion, we recommend that this occurs. Consultation will provide stakeholders with the opportunity to input into the operations of the scheme and will help avoid unintended or unperceived consequences. For example, we will be seeking to ensure that AFCA's terms of reference include the requirement for complaints to fully progress through a firm's IDR before they can be managed by AFCA. We would also expect the terms of reference to include AFCA's jurisdictional limits.

The Exposure Draft Bill requires the new EDR scheme operator to obtain ASIC approval before any material changes can be made to the scheme. While the ICA welcomes increased ASIC oversight, the balance between ASIC's powers and the responsibility of the AFCA Board must be carefully constructed. Strengthened regulatory oversight should not foster an overly bureaucratic scheme that is unable to respond quickly to changes within the financial system.

To provide a responsible balance, the ICA submits that AFCA's terms of reference must require consultation with relevant stakeholders before any material changes are implemented. The terms of reference must enshrine the scheme's accountability to its members and users.

The Bill provides ASIC with the specific power to direct the EDR scheme to increase some or all of the monetary limits that relate to the value of claims that can be considered by the scheme. ASIC is required to give the scheme operator a minimum of three months' notice.

As we detail later in the submission, increasing monetary limits has broad implications and must only be carried out after thorough consideration and consultation. To reduce the risk of monetary limits being arbitrarily increased, we suggest that instead, the methodology by which the limits are determined should be subject to periodic review to ensure they remain in line with specified economic parameters.

Additionally, any power provided to ASIC to increase monetary limits must be a reserve power only. There should be a specific requirement for ASIC to consult with stakeholders and give due consideration to the consequence for PI insurance requirements before a direction regarding monetary limits is given.

It is vital that the Bill ensures ASIC directions are given in accordance with the principles of transparency and accountability. This should help provide a clear delineation between ASIC's regulatory oversight and the responsibility of the AFCA Board to ultimately manage the operations of the scheme. This separation is fundamental to ensure that AFCA operates impartially and independently.

Question 4

Are there any additional issues that should be considered to ensure an effective transition to the new EDR scheme?

While AFCA will be a new EDR scheme, leveraging off already established EDR processes should not be discouraged. Building on the existing arrangements financial service providers are accustomed to, and have systems in place for, will greatly assist the transition and minimise the amount of disruption to industry and consumers. This will be especially needed during the period of time when existing EDR schemes are still operating alongside AFCA.

Existing resources such as staff, assets and IT infrastructure should also be utilised to minimise cost and disruption. Recent updates from FOS reveal that 10,143 disputes were received in the January to March 2017 quarter. This represents a 6% increase compared with the last quarter and an 18% increase compared with the December quarter of the previous year.[1] At present there are no signs of dispute numbers abating. From a practical resourcing perspective, the expertise already accumulated at FOS must be utilised if disputes are to be effectively managed at AFCA from 1 July 2018.

Another factor significant to an effective transition will be ongoing communication with stakeholders, making sure they are kept abreast of changes. In this regard, the ICA would welcome additional consultation on AFCA's fee structure. During the transition period our members may be required to pay fees to two different schemes. As budgets will be set in advance, our members will require certainty about AFCA's funding arrangements. We recommend that the funding structure is kept the same as FOS, with a review once the scheme has been in place for some time.

Under the heading 'a smooth transition', the Treasury Fact Sheet informs us that a consumer will have the option to transfer their complaint to AFCA if they wish to do so. The ICA does not believe that such a policy is conducive for a smooth transition. A dispute lodged with FOS before 1 July 2018 should proceed through the FOS dispute resolution system and be bound by the determination of that scheme. If this does not occur, there will be an incentive for consumers to transfer a dispute to AFCA, if it becomes apparent that the dispute is unlikely to be resolved in their favour. AFCA will then have to commence assessment of the dispute, duplicating the work already carried out by FOS. As previously noted, AFCA is likely to have a significant amount of disputes to resolve. Allowing consumers to transfer disputes already

[1] *FOS Circular*, Issue 29 – April 2017.

being processed will place unnecessary pressure on AFCA and lead to backlogs at the scheme's inception.

Question 5

Would moving immediately to a compensation cap of $1 million have significant impacts on the availability/price of professional indemnity insurance?

The ICA is concerned by proposals to immediately increase the compensation cap for certain products to $1 million, and to generally increase compensation caps and monetary limits for all disputes. We submit that such increases will impact the availability and price of PI insurance which Australian Financial Services Licensees (Licensees) are required to hold in accordance with ASIC Regulatory Guide 126 (RG 126).

PI insurance operates to ensure that in the majority of cases Licensees are able to pay compensation awarded against them. PI insurance for Licensees is offered by a relatively limited number of insurers. In the past, there have been periods when the availability and affordability of this type of insurance has been problematic due to a relatively volatile claims history and the withdrawal of insurers from this specialised sector. We remain highly concerned that a similar situation will be triggered if compensation caps were to significantly increase.

An increase in the compensation cap will bring within the jurisdiction of AFCA complex high-value claims not suited to an ombudsman EDR arrangement. The core strength of ombudsman schemes is the ability to provide a quick, cost-effective solution for resolving disputes. Under such a model, for small disputes, the absence of legal proceedings is a tolerable trade-off. For high-value claims this trade-off is precarious, and in conflict with the basis of the PI insurance model.

The PI insurance model is based on long established assumptions that include:

- Claims against the insured will be the subject of a robust legal defence;
- Claims will be heard in the jurisdiction of a competent court with all the attendant rules and processes;
- Judgments in respect of a claim in a court of first instance will be open to appeal to a higher jurisdiction; and
- Aspects of insured risk that are likely to significantly distort outcomes may be excluded from policy coverage or subject to some form of limited cover.

These assumptions are designed to establish an acceptable level of certainty in insurance outcomes that are necessary to establish appropriate and stable pricing.

While the structure of an EDR scheme is not in line with these stated assumptions, some PI insurers have been able to provide cover to Licensees on the basis that claims that proceed to FOS are of a relatively moderate value. These PI insurers have therefore absorbed cover for FOS claims into their policies without a material adjustment to their insurance model. An increase in monetary limits to $1 million may not be readily absorbed due to the increased uncertainty of insurance outcomes. It will ultimately be up to individual PI insurers to determine how best to respond; however responses could include:

- Offering cover to the new limit but increasing premiums to account for the increased exposure to AFCA jurisdiction and the uncertainty of claim outcomes. Insurers may also look to increase the policy excess applicable to AFCA matters.
- Continuing to offer cover to the current limit but considering cover to the increased limit on a case by case basis (with or without additional premium).
- Withdrawing from the market for PI for Licensees.

Increasing the compensation cap to $1 million also has a broader impact on the general insurance industry by introducing greater uncertainty to the claims determination process. As we have noted in our previous submission, the question of whether future claims should be decided in accordance with the Ombudsman's decision in individual claims, or established court precedent, creates uncertainty. Insurers must decide how this uncertainty, created when legal precedent is not followed, should be factored into premium pricing for all affected classes of insurance.

The Bill contains provisions that will require superannuation disputes to be determined in a manner consistent with the law. The ICA submits that the same provisions should apply to all disputes. Specifically, we would like to see the proposed section 1057(3)(a) – requirement that all decisions must not be contrary to the law, and proposed sections 1056 and 1061(1) - provisions for appeal, to be extended to all disputes.

AFCA is designed to be a single 'one-stop-shop' EDR scheme. It would appear logical that the same decision-making principles apply to all disputes. Under this single EDR scheme arrangement all disputes, regardless of the type, must be held to the same standard. If high-value complex disputes are to be decided by AFCA, it becomes particularly imperative to have a right to appeal. A mechanism to test matters of law will provide greater assurance to PI insurance providers and the general insurance industry more widely.

Treasury have advised that there will be further consultation on whether consumer disputes relating to certain products, including general insurance products, should move immediately to a compensation cap of $1 million. This Consultation Paper seeks feedback on the implications of such an increase for PI insurance. The ICA seeks a more detailed and thorough consultation on this proposal, to take into account the broader impact for the general insurance industry.

Question 6

Are the existing sub-limits for different insurance products still required?

While there are some claims where an increased cap could be beneficial, for example disputes relating to property, the vast majority of general insurance disputes are of a low average claim amount.

We note that FOS has identified an issue regarding unpaid determinations by certain financial service providers, this is a separate matter to inadequate compensation amounts. To date, there has been no compelling evidence to suggest that the current caps and limits are inadequate for the majority of claims.

Question 8

What will the regulatory impacts of the new EDR framework be?

As noted in response to question 4, many practical steps can be taken to minimise the regulatory burden of the new scheme by aligning AFCA processes, resources and systems with those already in place.

The new scheme will require its members to report to ASIC on their internal dispute resolution (IDR) activity in a standardised form yet to be determined. While the ICA acknowledges this policy intent, which is to allow for greater comparability of IDR data, we would like to highlight the challenges of accurately comparing IDR data among financial service providers.

At present, different firms collect and report on IDR in varying ways. ASIC will have to work closely with industry if it wishes to embed standardised IDR reporting. Consideration will have to be given to the entire IDR process, including how individual firms escalate matters to IDR and how this escalation process can be appropriately compared.

Some organisations will have a robust IDR regime that comprehensively captures all disputes and ensures relevant complaints are escalated. Such firms would inadvertently be penalised as their thorough IDR process would result in more disputes being recorded. Under such circumstances, high levels of complaints captured at IDR would not necessarily equate to a firm having more dissatisfied customers than another. Instead, it is a sign that complaints are being recorded and managed through the appropriate process.

The ICA submits that the number of disputes lodged at IDR is not an accurate or helpful indication of a firm's performance. A crude publication of IDR data has the potential to be highly misleading and unhelpful. If ASIC is to embark on the publication of firm-specific IDR data, the data must be contextualised, with accompanying information on the firm's size and products, and commentary on their dispute resolution process more broadly.

In order to minimise the regulatory impact of ASIC collecting IDR data there will need to be appropriate lead times and a transitional period. This should give organisations the time to develop new reporting capabilities. To minimise the regulatory cost, our members would welcome the opportunity to engage with ASIC early on any new IDR reporting requirements.