

ACCC Inquiry – Residential Insurance in Northern Australia

Interim report released in December 2018

AFCA submission

April 2019

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Introduction

The Australian Financial Complaints Authority (AFCA) is the new independent external dispute resolution (EDR) scheme for the financial sector. It replaces the Financial Ombudsman Service (FOS), the Credit and Investments Ombudsman (CIO) and the Superannuation Complaints Tribunal.¹

AFCA's purpose is to provide fair, independent and effective solutions for financial disputes. It does this not only by providing fair dispute resolution services, but also by working with financial firms to improve their processes and drive up industry standards of service, thereby minimising disputes.

More broadly, AFCA will play a key role in restoring trust in the financial services sector.

In addition to providing solutions for financial disputes, AFCA has responsibilities² to identify, resolve and report on systemic issues and to notify the Australian Securities and Investments Commission (ASIC), and other regulators, of serious contraventions of the law.

On 23 April 2018, AFCA was authorised pursuant to the *Corporations Act 2001*. The AFCA Rules, which govern our operations, were approved by ASIC in September 2018. We began to receive complaints under these rules on 1 November 2018.

AFCA welcomes the opportunity to provide feedback on the *First Interim Report on the Northern Australia Insurance Inquiry* released by the ACCC on 18 December 2018 (Interim Report). This submission³ draws on the experience of the predecessors of AFCA – organisations that have handled general insurance complaints for more than 25 years.

Key points in this submission are:

Complaint resolution

- AFCA's jurisdiction

The description of AFCA's jurisdiction in the Interim Report requires corrections. Section 1.1 of this submission explains how the corrections could be made.

- Informing consumers of their EDR rights

¹ The Appendix provides a brief overview of AFCA. For comprehensive information about AFCA, see our website www.afca.org.au.

² See [ASIC's Regulatory Guide 267](#) *Oversight of the Australian Financial Complaints Authority*.

³ This submission has been prepared by the staff of AFCA and does not necessarily represent the views of individual directors of AFCA.

Part of Recommendation 12 is designed to ensure consumers are aware of their EDR rights. Noting that ASIC's Regulatory Guide 165 (RG 165) sets requirements for insurers to inform consumers of their EDR rights, section 1.2 suggests the Inquiry examines these requirements. The current review of RG 165 may need to consider Recommendation 12.

Recommendations

As section 2 explains, AFCA has already supported approaches taken in the recommendations set out in the Interim Report. Our submission in March to Treasury's consultation on general insurance disclosure supported:

- Recommendation 10, to require renewal notices to disclose the premium, sum insured and excess of the expiring policy.
- Recommendation 7, to require quotes for new insurance and renewal notices to include links to the MoneySmart website.
- Recommendation 5, to enhance the standard cover regime. AFCA believes consideration should also be given to –
 - > basing standard cover on minimum coverage designed to have low premiums and allowing insurers to add extra features (for higher premiums disclosed clearly)
 - > requiring a participating insurer to provide minimum coverage at three levels – basic, intermediate and premium (and allowing extra features to be added to insurance at any level).
- Recommendation 4, to standardise definitions of key terms used in insurance policies.

Draft recommendations

AFCA believes that all of the draft recommendations in the Interim Report should be considered and supports these recommendations in broad terms. Section 3 sets out comments on some of the draft recommendations, including suggestions as follows:

- Draft Recommendation 1

The estimates proposed in Draft Recommendation 1 should be presented in qualified terms to highlight their limitations and prompt a consumer to consider whether the estimate they receive is accurate.

- Draft Recommendation 2

Enhancements to key facts sheet requirements should be coordinated with reforms to the standard cover regime and the standardisation of definitions. If key facts sheets are made more effective, AFCA believes they should be given more prominence in disclosure information provided online.

- Draft Recommendation 3

AFCA agrees with Draft Recommendation 3 applying to inclusions but does not see this as practicable for exclusions.

Certain exclusions could cause insurance to become a low value product. Draft Recommendation 3 does not include any limits to address this. The proposed disclosure might also draw attention to low value insurance and make it appear more attractive (due to the focus on cost).

- Draft Recommendation 4

It is essential for the comparison website proposed in Draft Recommendation 4 to be independent.

- Draft Recommendation 10

The enhanced disclosure requirements proposed in Draft Recommendation 10 should apply to all insurance brokers – not just in relation to home insurance.

- Draft Recommendation 11

AFCA believes consumers should have more control over how claims are settled but has concerns that the proposals in Draft Recommendation 11 could have unintended consequences.

The proposals would affect the handling of complaints relating to cash settlements and could reduce the scope for consumers who suffer loss to seek compensation through EDR. If Draft Recommendation 11 is implemented, strong consumer safeguards should be put in place. For example, there should be measures to ensure that a consumer does not choose between a cash settlement and a repair or replacement until they obtain –

- > independent advice and
- > their own quotes for the repair or replacement.

Where an insured property is mortgaged and a cash settlement of a claim is paid, an additional concern arises. The mortgagee may be entitled to require the payment to be used to reduce the outstanding balance of the loan. In this situation, after the cash settlement, the mortgagor may not be able to afford to repair their damaged property. If Draft Recommendation 11 proceeds, this issue should be taken into account when formulating the requirements for disclosure before cash settlements.

1. Complaints resolution

1.1 AFCA's jurisdiction

The submission to the Inquiry made by FOS in April 2018 outlined the monetary limits on the jurisdiction of FOS and its compensation caps. AFCA operates with different limits and caps, which are explained in Section D of [AFCA's Operational Guidelines](#).

On page 218, the Interim Report briefly describes AFCA's jurisdiction to consider complaints about home insurance (including home, contents and strata title insurance complaints). This material requires corrections. We suggest alterations to address the points noted below.

- AFCA operates with a monetary limit to its jurisdiction and caps on the compensation it can award.

In a home insurance complaint:

- > AFCA cannot consider a claim for an amount exceeding the monetary limit, which is \$1 million
 - > AFCA cannot award compensation exceeding relevant compensation caps⁴ which include caps, per claim, of
 - \$250,000 in complaints against general insurance brokers and \$500,000 in other complaints
 - \$5,000 on any compensation for indirect financial loss or non-financial loss.
- AFCA's monetary limits and compensation caps apply **per claim**.

The term 'claim' in this context refers to the set of events and facts that together lead to the losses in a complaint submitted to AFCA and give the complainant the right to ask for a remedy.⁵ Explaining this helps to avoid possible confusion with an insurance claim, which is an application for benefits under an insurance policy.

- One complaint may contain more than one claim.

The Interim Report explains this in the second paragraph on page 281. To make the explanation clearer, we suggest using the terms 'monetary limit' (instead of 'total monetary claim limit') and 'compensation cap' (instead of 'potential compensatory limits').

⁴ AFCA has jurisdiction to consider complaints involving amounts larger than the caps, but can only award amounts up to the caps.

⁵ For further detail, refer to page 184 of [AFCA's Operational Guidelines](#).

The second paragraph on page 218 of the Interim Report points out that limits on the jurisdiction of AFCA need to be reviewed regularly. We note that AFCA is required to adjust these limits on 1 January 2021 and every three years after that date, and ASIC may require AFCA to make additional changes to the limits.⁶

The third paragraph on page 218 states that AFCA **will** make a determination if a dispute is not resolved by agreement. Complaints not resolved by agreement may have outcomes other than determinations, such as an assessment or discontinuance. To address this, we suggest changing 'will' to 'may'.

Please note a recent change in EDR terminology. AFCA uses the term 'complaint' where FOS used the term 'dispute' in the past.

1.2 Informing consumers of their EDR rights

Pages 216 and 217 of the Interim Report set out obligations in the General Insurance Code of Practice that relate to complaints handling. They include requirements to inform consumers of their EDR rights within specified timeframes.

The Interim Report suggests an addition to these requirements in Recommendation 12. Part of that recommendation is to amend the code so that, when a consumer lodges a claim, the code requires the insurer to give the consumer information about their right to use internal dispute resolution (IDR) and EDR mechanisms.

The Interim Report acknowledges that insurers must have IDR procedures meeting standards imposed through [ASIC's RG 165](#)⁷. However, the report does not discuss these standards. We raise this because RG 165 imposes requirements for insurers to inform consumers about their rights to EDR within specified timeframes.⁸ As RG 165 sets standards in regard to IDR that insurers must meet and the code must accord with RG 165, we believe the Inquiry should examine these standards as well as corresponding code requirements.

A review of RG 165 is being conducted at present. As Recommendation 12 involves a departure from RG 165, the review may need to consider the recommendation.

1.3 Agreed amendment to General Insurance Code of Practice

The final report on the recent review of the General Insurance Code of Practice⁹ states on page 67 that the Insurance Council of Australia agrees to amend the code 'so that an insurer is required to inform consumers in writing where they are unable to provide a decision about a complaint within 45 calendar days'. On page 217, the Interim Report refers to this point being **recommended** (not acknowledging that it

⁶ See [AFCA Rules](#), rule D4.3

⁷ Footnote 390 in the Interim Report acknowledges this.

⁸ See RG 165, especially paragraphs 86-94 and 121-132.

⁹ [Final Report, Review of the General Insurance Code of Practice](#) released by the ICA in June 2018.

was agreed) and does not clearly state the requirement agreed. We suggest this sentence be reviewed.

2. Recommendations

A discussion paper about general insurance disclosure, released by Treasury in January¹⁰, addressed several issues within the scope of the current Inquiry. In March, AFCA made a written submission¹¹ in response to Treasury’s paper. Feedback in our submission is relevant to recommendations in the Interim Report, as noted below.

Feedback in AFCA submission	Relevant recommendation in Interim Report
<p>Disclosure in renewal notices</p> <p>AFCA believes renewal notices should be required to disclose:</p> <ul style="list-style-type: none"> • component pricing, including information on items such as flood cover and taxes • the previous year’s premium, sum insured and excess, and possibly taxes for that year • an explanation of any premium increase. 	Rec 10
<p>Links to MoneySmart website</p> <p>AFCA supports the approach of requiring quotes for new insurance and renewal notices to include links to the MoneySmart website.</p>	Rec 7
<p>Standard cover regime</p> <p>AFCA believes enhancements to the standard cover regime should be made along the lines recommended in the Interim Report, making offers of standard cover mandatory. Consideration should also be given to:</p> <ul style="list-style-type: none"> • basing standard cover on minimum coverage designed to have low premiums and allowing insurers to add extra features (for higher premiums disclosed clearly) • requiring a participating insurer to provide minimum coverage at 3 levels – basic, intermediate and premium (and allowing extra features to be added to insurance at any level). 	Rec 5

¹⁰ [Disclosure in General Insurance: Improving Consumer Understanding](#) Treasury Discussion Paper, January 2019.

¹¹ [General Insurance Disclosure](#), AFCA Submission, March 2019.

Feedback in AFCA submission	Relevant recommendation in Interim Report
<p>Standard definitions</p> <p>AFCA considers that standardisation of the definition of ‘flood’ has reduced dispute levels and consumer confusion. In our view, definitions of other key terms - including ‘action of the sea’, ‘impacts’ and ‘storm’ - should be standardised.</p>	Rec 4

Some reforms recommended in the Interim Report were supported by AFCA’s predecessors. For example, FOS supported proposals to:

- amend the General Insurance Code of Practice to meet the requirements for approval under ASIC’s Regulatory Guide 183 and submit the amended code for approval
- extend unfair contract term protections to apply to insurance.

AFCA maintains a consistent stance. We note that the recent Royal Commission made recommendations relating to industry codes and unfair contract term protections that are being progressed at present.

3. Draft recommendations

AFCA believes that all of the draft recommendations in the Interim Report should be considered and supports these recommendations in broad terms. We have comments on some of the draft recommendations, as noted below.

3.1 Draft Recommendation 1

There is a risk that, if an insurer’s estimate of a sum insured is too low, the estimate could cause or be a factor leading to underinsurance. Inaccurate low estimates could also give rise to complaints where underinsured consumers suffer losses.

In our view the proposed estimates should be presented in qualified terms to highlight their limitations and prompt a consumer to consider whether the estimate they receive is accurate.

3.2 Draft Recommendation 2

AFCA believes that key facts sheets must be used with – not instead of – product disclosure statements. We support the approach of requiring the key facts sheet and product disclosure statement for a product to be published together.

The AFCA submission to Treasury referred to above explains our view that enhancements to key facts sheet requirements should be coordinated with reforms to the standard cover regime and the standardisation of definitions. If key facts sheets are made more effective, we consider that they should be given more prominence in disclosure information provided online.

3.3 Draft Recommendation 3

AFCA agrees with Draft Recommendation 3 applying to inclusions but does not see this as practicable for exclusions.

The proposed disclosure might show a large premium saving for an exclusion of an essential aspect of insurance cover or for multiple exclusions. Such exclusions may cause the insurance to become a low value product, however.

Another issue is that the style of disclosure proposed could draw attention to lower value insurance and make it appear more attractive (due to the focus on cost).

It may be possible to address the issues noted above by setting limits on exclusions. This approach may cause disclosure requirements, and disclosure material provided to consumers, to become quite complicated however.

3.4 Draft Recommendation 4

We note that Draft Recommendation 4 refers to development of a comparison website that is independent. It is essential for a comparison website to be independent and not subject to industry manipulation. A commercial website could be misleading.

AFCA believes consideration should be given to covering home contents, as well as building, insurance on the proposed website.

3.5 Draft Recommendation 6

AFCA supports initiatives to increase disclosure about expected premium increases. We anticipate that it may be difficult for insurers to provide the estimates referred to in Draft Recommendation 6, however. Difficulties may arise, for example, in identifying all of the risk issues in reinsurance. As acknowledged on page 177 of the Interim

Report, the proposal could also make it easier for insurers to obtain more information about their competitors.

3.6 Draft Recommendation 10

AFCA agrees with Draft Recommendation 10 but believes it should apply to all insurance brokers – not just in relation to home insurance. In our view, it would not be fair to impose the proposed disclosure requirement only on one group of brokers.

3.7 Draft Recommendation 11

AFCA believes consumers should have more control over how claims are settled. We have concerns that Draft Recommendation 11 could have unintended consequences however.

As acknowledged in the Interim Report, the cost of a building repair may be higher for a consumer than it is for an insurer. It follows that, after a cash settlement based on estimated repair costs for the insurer, the consumer may find that the settlement does not cover their repair costs.

At present, in most cases an insurer has the discretion to settle a claim by making repairs or paying an amount equal to the estimated cost of the repairs. AFCA handles complaints about cash settlements in this situation.

Our Operational Guidelines explain how we determine remedies awarded in complaints. One of the key statements about remedies in the guidelines is:

When deciding the remedy, we often seek to achieve, as nearly as possible, either:

- to place the Complainant in the position they would have been in if the conduct of the Financial Firm had not caused the loss; or
- to compensate the Complainant for their loss to the extent AFCA holds the Financial Firm responsible for the loss.¹²

A consumer may make a complaint to AFCA if a cash settlement of \$X, based on estimated repair costs to the insurer, does not enable the consumer to repair their damaged property. Following the approach outlined in the guidelines, AFCA may award compensation, meaning that total payments to the consumer exceed \$X.

If changes are made in accordance with Draft Recommendation 11, consumers would be given the right to choose between a repair and a cash settlement. This would be expected to affect complaints as illustrated in the scenario discussed below.

¹² [AFCA's Operational Guidelines](#), page 183.

Scenario:

- Insured property is damaged and the insurer estimates the repair cost to be \$Y.
- The insurer wants to repair the property but the consumer insists on a cash settlement, also of \$Y.
- The consumer cannot repair the property for \$Y and takes a complaint to AFCA.

AFCA Rules:

When determining a complaint, AFCA decides what is fair in all the circumstances.¹³

Comments:

- The consumer in this scenario may have limited scope to complain (compared to the present position described above).
- AFCA may find that the payment of \$Y is fair in the circumstances given the consumer's choice.

- Need for strong consumer safeguards

If Draft Recommendation 11 proceeds, we anticipate that responsibilities of consumers will increase and their possible recourse to EDR will decrease. Changes of the type proposed should only be made in our view if strong consumer safeguards are put in place.

Consumer safeguards should, for example, include measures to ensure that a consumer does not choose between a cash settlement and a repair or replacement until they obtain:

- > independent advice and
- > their own quotes for the repair or replacement.

- Mortgaged property

Where an insured property is mortgaged and a cash settlement of a claim is paid, an additional concern arises. The mortgagee may be entitled to require the payment to be used to reduce the outstanding balance of the loan. This may occur, for example, in a falling property market. The outcome may be that a mortgagor with a damaged property cannot afford repairs even though their insurance claim was paid.

If Draft Recommendation 11 proceeds, this issue should be taken into account when formulating the requirements for disclosure before cash settlements.

¹³ See the explanation of rule A14.2 of the AFCA Rules in our Operational Guidelines.

3.8 Draft Recommendation 13

AFCA supports the approach described in Draft Recommendation 13 but anticipates that it may be difficult to specify the proposed requirement. This may involve, for example, defining 'properties with similar characteristics'.

Appendix – About AFCA

AFCA is a free, fair and independent dispute resolution scheme. AFCA's service is offered as an alternative to tribunals and courts to resolve complaints that individual and small business consumers have with their financial firms. We consider complaints about:

- credit, finance and loans
- insurance
- banking deposits and payments
- investments and financial advice
- superannuation.

AFCA's role is to assist consumers to reach agreements with financial firms about how to resolve their complaints. We are impartial and independent. We do not act for either party to advocate their position. If a complaint does not resolve between the parties, we will decide an appropriate outcome.

Decisions made by AFCA can be binding on the financial firm involved in a complaint. We can award compensation for losses suffered because of a financial firm's error or inappropriate conduct. There are other remedies we can also provide for superannuation complaints.

AFCA is not a government department or agency, and is not a regulator of the financial services industry. We are a not-for-profit company, limited by guarantee, governed by a board with equal numbers of industry and consumer representatives. AFCA's Chief Ombudsman is responsible for the management of the organisation.

Under transitional arrangements that have been put in place with ASIC's approval, AFCA is currently resolving complaints made to FOS and CIO and will continue to do so until they are resolved. These complaints will be handled in accordance with the FOS Terms of Reference or CIO Rules, as applicable and in force when the relevant complaint was lodged.