The AFCA Approach to awarding interest in insurance

We have created a series of AFCA Approach documents, such as this one, to help consumers and financial firms better understand how we reach decisions about key issues.

These documents explain the way we approach some common issues and complaint types that we see at AFCA. However, it is important to understand that each complaint that comes to us is unique, so this information is a guide only. No determination (decision) can be seen as a precedent for future cases, and no AFCA Approach document can cover everything you might want to know about key issues.

1 At a glance

1.2 Scope

This paper discusses how AFCA awards interest in general insurance complaints. The approach was developed by AFCA's predecessor scheme, FOS and is adopted by AFCA.

This approach will affect financial firms involved in the insurance industry, their customers and their representatives.

1.3 Summary

Interest will normally be awarded if AFCA accepts the consumer is owed a sum of money under the policy.

Interest will not likely be awarded when:

- the financial firm is liable to repair or replace the relevant item; or
- AFCA determines that the relevant sum to be paid is based on current rates.

Interest is payable from the date it was unreasonable for the financial firm to have withheld payment of the amount it was liable to pay. This will usually be:

- the date the claim was denied
- if there has been an unreasonable delay before the financial firm denied the claim – an earlier date that is considered reasonable; or
- the date when the benefit was due to be paid under the policy (for example after the expiry of a waiting period in an income protection policy).

AFCA may also take into account other factors, such as whether a consumer has unreasonably failed to provide information reasonably requested by the financial firm.

The relevant interest rates are available on AFCA's website and calculated in accordance with section 57 of the *Insurance Contracts Act 1984* (the Act).

Any award of interest is not limited to AFCA's compensation cap. For example, AFCA can award the maximum remedy available for a claim ($542,000) plus interest on top of that.

If compensation for non-financial loss is awarded in accordance with section D.3.3 of the AFCA Rules, interest will not apply to that amount.

2 In detail

2.2 Relevant legal principles

Under section 57(2) of the Act, if an insurer is liable to pay an amount to a person under an insurance contract, they are also liable to pay interest in the following circumstances:

"The period in respect of which interest is payable is the period commencing on the day as from which it was unreasonable for the insurer to have withheld payment of the amount and ending on whichever is the earlier of the following days:

(a) the day on which the payment is made;

(b) the day on which the payment is sent by post to the person to whom it is payable."

Essentially, if the insurer has incorrectly denied a claim, even on a genuine and reasonable basis, it is still liable to pay interest on any amount owed. The rationale is the insurer adopted a legally incorrect position and as a result, the consumer is entitled to be paid interest on the amount owing to them.

2.2 Period of interest payable

Insurers are to be allowed a reasonable period to investigate and determine their position.

What is reasonable is a factual question based on the individual circumstances of the case.

This case by case analysis is supported by a number of the Court decisions where the following periods were determined as being reasonable to the circumstances of those cases:

Timeframe	Context
24 days	Loss of a yacht
1 month	Total destruction of a vehicle
45 days	Fire to premises and stock where the insurer was denying the claim based on misrepresentation
6 weeks	Loss of a fishing vessel
2 months	Fire to a home that was considered suspicious
3 months	Fire destroying contents

In most cases, the period will begin when the financial firm incorrectly denies the claim.

However, AFCA may determine a different point of time if:

- there has been an unreasonable delay between when the event arose and the claim decision was made; or
- the financial firm refuses to make a decision at all.

The conduct of a consumer is only relevant if it is a factor in determining what a reasonable period to investigate the claim entails.

This can arise in circumstances when the consumer refuses to comply with the financial firm’s reasonable requests to supply information relevant to the issue of liability. In such a scenario, it is clear their conduct would have delayed the financial firm’s ability to investigate and determine its position.

Any delay by the consumer in bringing the complaint to AFCA is not usually taken into account.

2.3 When interest may not be payable

Interest is only payable when a sum of money is owed to a “person” (the consumer) who is covered by the policy.

This is because interest is designed to compensate the loss suffered by a consumer owed money under the terms of the policy due to factors such as inflation and currency fluctuation.

Given this, interest in not payable in the following circumstances:

Situation	Reasons
Financial firm repairs or replaces the item	Consumer is being fully indemnified Money is payable to supplier, not the consumer
Paying a sum of money based on current rates	Consumer is being fully indemnified as the settlement is based on the actual cost to be incurred
Non-financial loss under section D.3.3 of the AFCA Rules	Not a sum of money owed under the contract of insurance as it is payable under AFCA’s terms of reference

2.4 Calculating interest

Section 57(2) of the ICA sets out the period that interest is to apply.

Regulation 38 of the *Insurance Contracts Regulation 2017* (ICR) sets out the rate to be applied. This is to be calculated by way of reference to the 10-year treasury bond yield at the end of the half-financial year, plus 3%.

AFCA publishes the rates on its website. The relevant link is set out at the end of this paper.

The rate to be applied is dependent on the relevant period and which half-financial year interest rate/s ends in that period, as evident by the following scenarios:

Situation	Relevant half yearly rates	Applicable rate
One half-financial year rate ending in the period. e.g. interest from 7 July 2013 until 4 April 2014.	7.24% - 31 December 2013	7.24% rate of the half-financial year that ends in the period
Multiple half-financial year rates ending in the period. e.g. interest from 3 September 2012 until 5 May 2014.	6.23% - 31 December 2012 6.76% - 30 June 2013 7.24% - 31 December 2013	6.5% average of 3 rates, which is 6.743% round down to the nearest quarter
No half-financial year rate ending in the period. e.g. interest from 3 September 2013 to 2 December 2013	6.76% - 30 June 2013	6.76% half-financial year that immediately preceded the period

2.5 Continuing benefits

Calculating interest can become complicated when there are ongoing benefits, such as:

- weekly benefits under income protection type policies
- loss of rent under landlord policies.

In those cases, interest would not always be calculated from the date of the financial firm's denial or when the financial firm should have accepted liability.

The reason is that benefits are payable at different dates. Accordingly, it is not unreasonable for the financial firm to have withheld payment prior to the relevant date.

An example of this rationale is set out in the case study below.

3 Context

3.1 Case studies

The case studies below are based on determinations by one of AFCA's predecessor schemes, the Financial Ombudsman Service. While previous determinations (by AFCA or by its predecessor schemes) are not binding precedents, where relevant they will inform AFCA's approach to an issue.

Case 1: Calculating interest for income protection

The consumer lodged a claim under an income protection policy on 1 January 2012.

Under the policy, weekly benefits of $1,000 are payable from 1 February 2012, two weeks in arrears. That is, the weekly benefit for the period between 1 and 8 February 2012 is payable on 15 February 2012.

The consumer's claim was denied by the financial firm on 1 March 2012.

On 1 December 2012, FOS determined the financial firm was liable to accept the claim and ought to have done so at 1 March 2012.

Given this, interest was payable from 1 March 2012 onwards for any benefits that would have been paid to the consumer prior to this date.

For benefits that would have been payable after 1 March 2012, interest applied to those amounts from the date the benefit would have been paid.

This can be illustrated as follows:

Date benefit payable	Amount	Interest payable from
15 February 2012	$1,000	1 March 2012
22 February 2012	$1,000	1 March 2012
1 March 2012	$1,000	1 March 2012
8 March 2012	$1,000	8 March 2012

3.2 References

Definitions

Term	Definition
Consumer	individual or small business that has lodged a complaint with AFCA

Term	Definition
Financial firm	a financial firm such as an insurer, who is a member of AFCA
ICA	Insurance Contracts Act 1984
ICR	Insurance Contracts Regulations 2017

Useful links

Document	URL
Rules	afca.org.au/rules
Interest Rates	afca.org.au/about-afca/rules-and-guidelines/application-of-interest/
Insurance Contracts Act	https://www.legislation.gov.au/Details/C2019C00115
Insurance Contracts Regulations	https://www.legislation.gov.au/Details/F2019C00310