

# The FOS Approach to Awarding Interest in Insurance

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|----------|----------------------------------|----------|
| <b>1</b> | <b>At a glance</b>               | <b>2</b> |
| 1.1      | Scope                            | 2        |
| 1.2      | Summary                          | 2        |
| <b>2</b> | <b>In detail</b>                 | <b>3</b> |
| 2.1      | Relevant legal principles        | 3        |
| 2.2      | Period of interest payable       | 3        |
| 2.3      | When interest may not be payable | 4        |
| 2.4      | Calculating interest             | 4        |
| 2.5      | Continuing benefits              | 5        |
| <b>3</b> | <b>Context</b>                   | <b>6</b> |
| 3.1      | Case studies                     | 6        |
| 3.2      | References                       | 6        |

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

These documents explain the way we approach some common issues and dispute types that we see at FOS. However, it is important to understand that each dispute 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 FOS Approach document can cover everything you might want to know about key issues.

# 1 At a glance

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## 1.1 Scope

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This paper discusses how FOS awards interest in insurance disputes.

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

## 1.2 Summary

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

Interest will not likely be awarded when:

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

Interest is payable from the date it was unreasonable for the FSP 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 FSP 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).

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

The relevant interest rates are available on FOS'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 FOS's compensation cap. For example, FOS can award the maximum remedy available for a claim (\$309,000) plus interest on top of that.

If compensation for non-financial loss is awarded in accordance with paragraph 9.3(b) of the Terms of Reference, interest will not apply to that amount.

## 2 In detail

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### 2.1 Relevant legal principles

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Under section 57(2) of the ICA, 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

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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:

| <b>Timeframe</b> | <b>Context</b>                                                                                |
|------------------|-----------------------------------------------------------------------------------------------|
| 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 FSP incorrectly denies the claim.

However, FOS 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 FSP 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 FSP'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 FSP's ability to investigate and determine its position.

Any delay by the consumer in bringing the dispute to FOS is not usually taken into account.

### 2.3 When interest may not be payable

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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 is not payable in the following circumstances:

| Situation                                                           | Reasons                                                                                                                                                   |
|---------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------|
| FSP repairs or replaces the item                                    | <ul style="list-style-type: none"><li>• Consumer is being fully indemnified</li><li>• Money is payable to supplier, not the consumer</li></ul>            |
| Paying a sum of money based on current rates                        | <ul style="list-style-type: none"><li>• Consumer is being fully indemnified as the settlement is based on the actual cost to be incurred</li></ul>        |
| Non-financial loss under paragraph 9.3(b) of the Terms of Reference | <ul style="list-style-type: none"><li>• Not a sum of money owed under the contract of insurance as it is payable under FOS's Terms of Reference</li></ul> |

### 2.4 Calculating interest

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

Regulation 32 of the Insurance Contracts Regulation 1985 (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%.

FOS 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. Eg:<br><ul style="list-style-type: none"> <li>Interest from 7 July 2013 until 4 April 2014.</li> </ul>          | 7.24% - 31 December 2013                                                     | 7.24%<br><ul style="list-style-type: none"> <li>rate of the half-financial year that ends in the period</li> </ul>                       |
| Multiple half-financial year rates ending in the period. Eg:<br><ul style="list-style-type: none"> <li>Interest from 3 September 2012 until 5 May 2014.</li> </ul> | 6.23% - 31 December 2012<br>6.76% - 30 June 2013<br>7.24% - 31 December 2013 | 6.5%<br><ul style="list-style-type: none"> <li>average of 3 rates, which is 6.743%</li> <li>round down to the nearest quarter</li> </ul> |
| No half-financial year rate ending in the period. Eg:<br><ul style="list-style-type: none"> <li>Interest from 3 September 2013 to 2 December 2013</li> </ul>       | 6.76% - 30 June 2013                                                         | 6.76%<br><ul style="list-style-type: none"> <li>half-financial year that immediately preceded the period</li> </ul>                      |

## 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 FSP's denial or when the FSP should have accepted liability.

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

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

### 3 Context

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#### 3.1 Case studies

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##### 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 FSP on 1 March 2012.

On 1 December 2012, FOS determined the FSP 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

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##### Definitions

| Term     | Definition                                                                                                                             |
|----------|----------------------------------------------------------------------------------------------------------------------------------------|
| consumer | individual or small business that has lodged a dispute with FOS                                                                        |
| FSP      | financial services provider, a business that has chosen FOS as its external dispute resolution scheme and provides a financial service |
| ICA      | Insurance Contracts Act 1984                                                                                                           |
| ICR      | Insurance Contracts Regulations 1985                                                                                                   |

## Useful links

| Document                                                            | URL                   |
|---------------------------------------------------------------------|-----------------------|
| <a href="http://www.fos.org.au/tor">Terms of Reference</a>          | www.fos.org.au/tor    |
| <a href="http://bit.ly/28OgCDI">Interest Rates</a>                  | http://bit.ly/28OgCDI |
| <a href="http://bit.ly/28PINoZ">Insurance Contracts Act</a>         | http://bit.ly/28PINoZ |
| <a href="http://bit.ly/28OkEeK">Insurance Contracts Regulations</a> | http://bit.ly/28OkEeK |