



Something to be reckoned with – Royal Commission recommendations for claims

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COMMISSIONER HAYNE'S FINAL REPORT

Many significant recommendations have been made in Commissioner Hayne's Final Report arising out of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry.

While there has been significant commentary about the recommendations broadly, one recommendation that is likely to have a significant impact on the insurance industry has received relatively little attention.

Recommendation 4.8 – that the handling and settlement of insurance claims, or potential insurance claims, should no longer be excluded from the definition of “financial service”¹ – will have serious and far-reaching implications for the general insurance industry if it is implemented.

Currently, the *Corporations Regulations 2001* (Cth)² excludes insurance claims handling and settlement services from the definition of “financial service”, meaning that:

- some of the general obligations imposed on general insurers who hold a financial services licence, including most importantly the obligation to do all things necessary to ensure that financial services are provided efficiently, honestly and fairly³, do not apply to claims management services, and
- ASIC has no direct oversight or power regarding claims management services provided by general insurers.

¹ Final Report, Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (**Final Report**), Recommendation 4.8.

² Regulation 7.1.33.

³ *Corporations Act 2001* (Cth) (**Corporations Act**), section 912A(1)(a).

Commissioner Hayne has criticised this exemption as having no basis in principle. He reasons that, "[i]f it were to be said that it would place an extra burden of cost on one or more insurers or on the industry generally, the argument would itself be the most powerful demonstration of the need to impose the obligation."

NEW TEST FOR DUTY OF UTMOST GOOD FAITH

The reality is that general insurers already owe obligations to conduct their claims management services in a manner consistent with the statutory duty to provide financial services efficiently, honestly and fairly. The most notable examples are the duty of utmost good faith implied into every general contract of insurance⁴ and the claims handling sections of the General Insurance Code of Practice⁵.

However, while the content of the duty is familiar to, and should already be observed by, all general insurers, the way contraventions are regulated and the consequences of any breach of these duties will radically alter if the recommendation to remove the claims handling exemption from the definition of financial services is implemented.

THREAT OF PENALTY A RADICAL SHIFT

There are several reasons why the change will be a radical shift for general insurers.

First, ASIC will assume direct responsibility for policing claims management services with its extensive investigative and regulatory powers. That means a general insurer's financial services licence will be directly exposed where its claims management services are not provided efficiently, fairly and honestly. This is a stark contrast to the current system where failings in claims management services are the domain of aggrieved individual insureds, the General Insurance Code Governance Committee⁶ and AFCA.⁷

Second, the claims handling side of a general insurer's business will be subject to all of its extensive financial services licence obligations. This includes providing adequate training and supervision to its representatives⁸ and compulsory breach reporting⁹. Again, any claims management failing will expose a general insurer's financial services licence and ASIC will be able to use its broad range of remedies and penalties where contraventions arise.

THIRD PARTY EXPOSURE

Third, and potentially most significantly, major issues will arise regarding the need for third party providers of general insurance claims management services to be either independently licensed (given they will be providing financial services) or formally authorised as a representative under the general insurer's licence¹⁰.

This will represent either a significant additional burden to third party providers (such as third-party claims administrators and loss adjusters) or a significant shift in the way general insurers structure their business from a claims handling perspective.

In turn, general insurers will be more exposed to the conduct of third-party claims service providers. Failings by third party providers will have implications for the general insurer's financial services licence as a result of the onerous agency provisions of the Corporations Act.

MORE TRAINING AND INCREASED INTERVENTION

This recommendation, if adopted, will have a significant impact on general insurers and third-party providers of claims handling services. The expansion of the duty to provide financial services efficiently, honestly and fairly to claims management services will create new regulatory obligations that will require many insurers to address governance, structural, training and qualification and risk management practices and will likely result in increased regulatory intervention by ASIC in claims management.

⁴ *Insurance Contracts Act 1984* (Cth), section 13.

⁵ Section 7 of the Code. More specifically, paragraph 7.2 states that "[insurers] will conduct claims handling in an honest, fair, transparent and timely manner, in accordance with [Section 7]." The Code, at paragraph 2.2, acknowledges that "a contract of insurance is a contract based on the utmost good faith."

⁶ Section 13 of the Code.

⁷ The Insurance Council of Australia also plays a role in preparing reports, as well as monitoring and updating the Code.

⁸ Corporations Act, section 912A(1)(f).

⁹ Corporate Act, section 912D.

¹⁰ Corporations Act, section 916A. Regard will need to be had to section 916D which prohibits one financial services licensee from being an authorised representative of another financial services licensee, and further, section 916E that refers to the exceptions in place regarding binders granted by insurers.

Watch this space for further, specific analysis from Wotton + Kearney of how Recommendation 4.8 will affect claims professionals.

Need to know more?

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