

## The general insurance industry in Australia

- 2.1 This chapter provides first a description of the general insurance industry in Australia. It then details the complex regulatory framework within which the industry operates.

### Background to the general insurance industry

- 2.2 Australia has a large, profitable and long-established general insurance market. Statistics from 2011 show that the private sector insurance industry generates gross premiums of \$34.9 billion per annum and has total assets of \$113.9 billion.<sup>1</sup> The industry employs approximately 60 000 people and on average pays out \$95 million per working day in claims costs.<sup>2</sup>
- 2.3 In 2011, the insurance industry in Australia earned \$42.1 billion in revenue with \$5.6 billion constituting profit. Suncorp, Insurance Australia Group (IAG), QBE Insurance Group Ltd and Allianz Australia Ltd are the main players in this market. The industry is characterised by high revenue volatility and high levels of competition.<sup>3</sup>

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1 Australian Prudential Regulation Authority, 'Statistics: Quarterly General Insurance Performance, September 2011', pp. 9-10 <<http://www.apra.gov.au/GI/Pages/quarterly-general-insurance-statistics.aspx>> viewed 20 December 2011.

2 Mr Robert Whelan, Chief Executive Officer, Insurance Council of Australia (ICA), *Committee Hansard*, Sydney, 14 October 2011, p. 38.

3 IBISWorld, 'IBISWorld Industry Report K7422: General Insurance in Australia', May 2011, p. 3, <<http://www.ibisworld.com.au/industry/default.aspx?indid=526>> viewed 9 January 2012.

- 2.4 The Global Financial Crisis greatly reduced the profitability of the insurance industry. A series of consecutive severe disaster events during 2010–2011, occurring over several regions, further exacerbated this problem.<sup>4</sup> There were floods and cyclones in Queensland, floods and storms in Victoria and bushfires in Western Australia, as well as earthquakes in New Zealand. It was noted that:

Undoubtedly the most significant contributing factor to the overall increase in general insurance claims during this year has been Australia's extreme weather events.<sup>5</sup>

- 2.5 The combination of these disaster events increased workload as well as stretching the resources of insurers and related external experts. Compared with 2008–09, the number of insurance claims lodged in 2009–10 across all classes of business rose seven per cent. The Insurance Council of Australia subsequently stated:

Delays in processing claims are inevitable ... when extreme demand is placed upon supply infrastructure, skills and labour availability within Australia and internationally.<sup>6</sup>

- 2.6 The insurance industry stated that it incurred unusually high financial costs as a result of these events. The Insurance Council of Australia noted that as at 24 June 2011, the industry had received for the extreme weather events an unprecedented number of 180 410 claims with an insurable cost of \$4.149 billion.<sup>7</sup> Industry research by IBISWorld estimated that the Queensland floods alone set insurers back \$500 million, with Suncorp and IAG being especially affected.<sup>8</sup> However, much of the risk was distributed amongst global reinsurers such as Swiss Re and Munich Re.

- 2.7 Most people purchase insurance directly through the insurer. A survey by legal aid groups showed that 63.55 per cent of respondents purchased their insurance by phone.<sup>9</sup> A minority of people purchase insurance through brokers and agents.

- 2.8 An important distinction must be made between brokers and agents of insurance. Brokers are independent while agents have loyalty to the

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4 IBISWorld, 'IBISWorld Industry Report K7422: General Insurance in Australia', May 2011, p. 4.

5 Financial Ombudsman Service (FOS), 'General Insurance Code of Practice – Overview of Year 2009/2010', p. 41 <[http://www.fos.org.au/centric/home\\_page/publications/general\\_insurance\\_code\\_of\\_practpra\\_yearly\\_overview.jsp](http://www.fos.org.au/centric/home_page/publications/general_insurance_code_of_practpra_yearly_overview.jsp)> viewed 10 January 2012.

6 Insurance Council of Australia (ICA), *Submission 16*, p. 2.

7 ICA, *Submission 16*, p. 2.

8 IBISWorld, 'IBISWorld Industry Report K7422: General Insurance in Australia', May 2011, p. 6.

9 Legal Aid NSW, *Submission 57*, Attachment 2, p. 20.

insurer. Insurance brokers arrange insurance on behalf of their clients. The National Insurance Brokers Association of Australia, described the role of the broker:

... to discuss with the client the nature of their risks, give some advice where appropriate on the management and mitigation of those risks, work with the client to identify appropriate insurance coverage for those risks and ultimately negotiate coverage to the market. [If] a claim has to be pursued, the broker then assists the client with the pursuit of that claim to the insurer and the resolution of the claim.<sup>10</sup>

- 2.9 Evidence showed that there is confusion among some consumers as to whether they approach the broker or the insurer directly if they have a dispute. The Committee received evidence that some insurers refused to deal with consumers who had engaged a broker.<sup>11</sup> Legal Aid Queensland reported that some of their clients who had engaged a broker had trouble obtaining a copy of their policies from the insurers themselves.<sup>12</sup>

## Regulatory framework

- 2.10 Insurers must comply with general contract law and a statute which deals with insurance contracts specifically.
- 2.11 Australian Government bodies are responsible for some elements of regulation, such as oversight of consumer protection and licensing, and by extension, internal and external dispute resolution. Insurers must adhere to capital adequacy laws.
- 2.12 However, the industry is self regulated with regard to the specifics of claims processing. The Insurance Council of Australia, as the peak body for insurers, and the Financial Ombudsman's Service, as the main provider of external dispute resolution for insurers, play vital roles.
- 2.13 The following provides a simplified overview of the regulatory framework and oversight bodies.

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10 Mr Dallas Booth, Chief Executive Officer, National Insurance Brokers Association of Australia, *Committee Hansard*, Sydney, 14 October 2011, p. 5.

11 Bruce Gillan, *Submission 64*, p. 3.

12 Legal Aid Queensland, *Submission 44*, pp. 6–7.

## Contract law

- 2.14 A contract of insurance protects against the adverse consequences of future events by transferring the risk of economic loss which might flow from the insured to the insurer. Australia has adopted and applied English laws relating to insurance.
- 2.15 The *Insurance Contracts Act 1984* (Cth) (Insurance Contracts Act) is the main legislation governing insurance contracts and came into effect in 1986.
- 2.16 Under an insurance contract, parties must act with utmost good faith towards each other. This means that each party must voluntarily disclose to the other during pre-contractual negotiations, any fact of which he or she is aware which would be 'material' to the negotiations. A fact is 'material' if it would have affected the mind of a prudent insurer in determining whether to accept the insurance, on what terms and at what premiums.
- 2.17 The intent of the Insurance Contracts Act is to:
- ... improve the flow of information from the insurer to the insured so that the insured can make an informed choice as to the contract of insurance he enters into and is fully aware of the terms and limitations of the policy; and to provide a uniform and fair set of rules to govern the relationship between the insurer and insured.<sup>13</sup>
- 2.18 However, the Insurance Contracts Act does not codify the law relating to insurance contracts.
- 2.19 The Insurance Contracts Act, like much legislation, has regulations which clarify its operation. The relevant regulation is the Insurance Contracts Regulations 1985 (Cth). For an insurance policy to provide 'standard cover', it must satisfy certain requirements set out in these regulations. However, under section 35(2) of the Insurance Contracts Act, insurers can provide cover which deviates from the standard if they inform the consumer of this fact.

## Government bodies

- 2.20 The government agency with a key responsibility for regulating insurers is the Australian Securities and Investments Commission (ASIC), an independent Commonwealth Government body. ASIC is Australia's

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13 Senator Gareth Evans, former Attorney-General, 'Second reading speech: Insurance Contracts Bill 1983', *Senate Hansard*, 1 December 1983, p. 3135, viewed 21 December 2011.

corporate, markets and financial services regulator. Its remit therefore includes insurers.

2.21 There are two laws pertaining to ASIC, the *Australian Securities and Investments Act 2001* (Cth) (ASIC Act), and the *Corporations Act 2001* (Cth) (Corporations Act). The ASIC Act provides consumer protection, while the Corporations Act provides for a licensing system for financial services providers. The licensing system includes a requirement for internal dispute resolution and external dispute resolution schemes.

2.22 With regard to the ASIC Act, ASIC told the Committee that:

The ASIC Act is that part of Australian Consumer Law that applies to financial services, and it has broad prohibitions, including prohibitions on misleading and deceptive conduct and unconscionable conduct.<sup>14</sup>

2.23 ASIC's jurisdiction over consumer protection in relation to claims handling is limited to its governing Act. This is because although the Corporations Act contains consumer protection provisions:

The Corporations Regulations exempt claims handling and settlement from the definition of a financial service. This means that some Australian financial services licence obligations – for example, the obligation to ensure that their financial services are provided efficiently, honestly and fairly – do not apply to the handling of general insurance claims.<sup>15</sup>

2.24 In 2010, legislative changes were introduced to the Parliament aiming to address this gap.<sup>16</sup> However the bill was not passed before the parliament was prorogued prior to the 2010 federal election. The bill is discussed further in Chapter 5 in the context of a mechanism to address consumer protections for the handling of insurance claims.

2.25 The Corporations Act established the licensing system for financial services. The *Financial Services Reform Act 2001* (Cth) came into effect from 2002 with a 'phase in' period to 2004. These reforms are primarily contained in Chapter 7 of the Corporations Act and are relevant to:

- the licensing and conduct of providers of general insurance products;

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14 Mr Greg Kirk, Senior Executive Leader, Deposit Takers Credit and Insurers, Australian Securities and Investments Commission (ASIC), *Committee Hansard*, Canberra, 22 September 2011, p. 1.

15 Mr Kirk, *Committee Hansard*, Canberra, 22 September 2011, p. 1.

16 The Insurance Contracts Amendment Bill 2010 was passed by the House of Representatives on 23 June 2010 and introduced in the Senate on 24 June 2010.

- the licensing and conduct of insurance intermediaries; and
  - financial services and financial product disclosure to retail consumers of general insurance products.
- 2.26 Australian financial services licensees, including insurers, must have a complaints dispute resolution system that consists of:
- an internal dispute resolution process that meets ASIC approved standards; and
  - be a member of an ASIC approved external dispute resolution scheme such as the Financial Ombudsman Service.
- 2.27 Formal regulatory guidance on these matters is contained in ASIC's Regulatory Guide 165 (RG 165), which is about the requirements for internal and external dispute resolution, and Regulatory Guide 139 (RG 139), which sets out guidance on the approval and oversight of external dispute resolution schemes.
- 2.28 Like insurers, brokers must hold an Australian Financial Service licence. Thus, brokers are subject to the same legal requirements as general insurers.<sup>17</sup> Brokers must provide services efficiently, honestly and fairly, and cannot engage in misleading or deceptive conduct. An ASIC report also notes that brokers may have common law fiduciary obligations.<sup>18</sup>
- 2.29 The Australian Prudential Regulation Authority (APRA) was established in 1998 to oversee the financial services industry, including the insurance industry. It is important to note that the APRA has responsibility only for the capital adequacy of insurers. This aspect of regulation, while important, is not the focus of the Committee's inquiry.
- 2.30 The APRA regulates 130 general insurers which collectively hold \$99.2 billion in assets. The APRA is funded largely by the industries it supervises, with levies from insurance companies constituting around 22 per cent of its income.
- 2.31 The APRA's mission is to establish and enforce prudential standards and practices designed to ensure that, under all reasonable circumstances, financial promises made by institutions under supervision are met within a stable, efficient and competitive financial system. The APRA stated:

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17 For more information about the regulation governing brokers, please see ASIC, *Insurance Broker Remuneration Arrangements*, Report No. 42, June 2005.

18 ASIC, *Insurance Broker Remuneration Arrangements*, Report No. 42, June 2005.

We are here to help ensure that customers' interests are protected and that benefits are delivered as promised. That is fundamental to what we do ... Our aim is to reduce the probability that a general insurer will fail so that, in all reasonable circumstances, it will meet its contractual obligations.<sup>19</sup>

- 2.32 The APRA administers the following Commonwealth legislation and regulations:
- *APRA Act 1998*;
  - *APRA Regulations 1998*;
  - *Insurance Act 1973*;
  - *Insurance Regulations 2002*; and
  - *Financial Sector (Collection of Data) Act 2001*.
- 2.33 This regulatory framework gives APRA the authority to issue mandatory prudential standards, non-enforceable prudential practice guides and reporting standards.
- 2.34 Another government body of some relevance is the Australian Competition and Consumer Commission (ACCC), which promotes competition and fair trade in the market place to benefit consumers, businesses and the community. Its primary responsibility is to ensure that individuals and businesses comply with the Commonwealth competition, fair trading and consumer protection laws.<sup>20</sup> However, as mentioned above, ASIC deals with consumer protection issues relating to financial services.
- 2.35 The operation of the general insurance industry is self regulated and operates under a voluntary code. The ACCC does not regulate voluntary codes of conduct and cannot enforce the breach of a voluntary code. The ACCC can only take action if a mandatory code of conduct is breached.
- 2.36 Consequently, neither the ACCC nor ASIC have jurisdictional oversight for insurance claims handling. This leaves consumers with few protections.

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19 Mr Ian Laughlin, Member, Australian Prudential Regulation Authority, *Committee Hansard*, 24 November 2011, p. 1.

20 Australian Competition and Consumer Commission, 'About Us' <<http://www.accc.gov.au/content/index.phtml/itemId/142>> viewed 29 November 2011.

## Insurance Council of Australia

- 2.37 The Insurance Council of Australia (ICA) represents the interests of the Australian general insurance industry. It was established in 1975 to act as the peak body for general insurance companies in Australia licensed under the Insurance Act. The ICA is funded by 53 industry members.<sup>21</sup> One of its objectives is to 'encourage improved service standards across the insurance sector and promote appropriate self-regulation'.<sup>22</sup>
- 2.38 The ICA is governed by a Board of Directors, which develops and has some responsibility for the General Insurance Code of Practice. This Code is discussed in greater detail in Chapter 3.

## Financial Ombudsman Service

- 2.39 The Financial Ombudsman Service (FOS) is an accredited external alternative dispute resolution provider under ASIC's requirements. It is a national, independent, impartial and non-profit body that takes complaints on a wide range of financial services.
- 2.40 When deciding disputes, FOS also has the discretion to award remedies which are not provided for in the Code.<sup>23</sup> Many of its decisions are based in general law rather than the Code; for example, it can consider general principles of contractual law<sup>24</sup> and the Insurance Contracts Act.<sup>25</sup>
- 2.41 Originally, there existed the Insurance Ombudsman Service, which assisted in resolving disputes between consumers and participating companies. The Insurance Ombudsman Service was merged with the Financial Industry Complaints Service and the Banking and Financial Ombudsman Service to form FOS on 1 July 2008.
- 2.42 Notably, the service is free to consumers. It operates as a user-pays service, funded by the insurance industry. That is, if a complaint is initiated against a particular insurance company, that company pays for

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21 ICA, 'Insurance Council of Australia Members' <<http://www.insurancouncil.com.au/AboutUs/OurMembers/tabid/1690/Default.aspx>> viewed 11 January 2011.

22 ICA, 'About Us' <<http://www.insurancouncil.com.au/AboutUs/OurRole/tabid/1288/Default.aspx>> viewed 1 December 2011.

23 FOS, 'Terms of Reference', p. 23 <<http://www.fos.org.au/public/download.jsp?id=17224>> viewed 10 January 2012.

24 See for example, FOS, 'Determination, Case number: 211177' <<https://forms.fos.org.au/DapWeb/CaseFiles/FOSSIC/211177.pdf>> viewed 19 December 2011. General principles of contract law are mostly based in case law, i.e. law decided by the courts.

25 See for example, FOS, 'Determination, Case number: 213228' <<https://forms.fos.org.au/DapWeb/CaseFiles/FOSSIC/213228.pdf>> viewed 19 December 2011.

the dispute to be resolved, including for any expert reports that are required to be commissioned.<sup>26</sup> The Ombudsman General Insurance told the Committee that:

Our aim is to provide consumers with a fast, efficient, independent and, importantly, free service to resolve disputes as quickly as possible. Our processes, unlike courts, are inquisitorial rather than adversarial. We emphasise that we are not a court but an alternative, with our determinations binding on a financial service provider but not binding on a consumer ... Our decisions are based on fairness, and our terms of reference require that we do what is fair in the circumstances, having regard to relevant legal principles and, in terms of insurance policies, good industry practice and prior determinations that we may have made, although they do not bind us going forward.<sup>27</sup>

- 2.43 Under RG 139, all insurers are required to be members of an external dispute resolution service. Most insurers use FOS, which has 59 participating insurance companies as well as 87 cover holders and third party administrators.<sup>28</sup> As part of ASIC's approval and continuing oversight of external dispute resolution schemes, it meets quarterly with representatives of the schemes, including FOS. At those meetings, the schemes update ASIC on emerging issues and complaints.
- 2.44 For general insurers, FOS also monitors and enforces the Insurance Code of Practice, and this role is discussed further in Chapter 3.
- 2.45 RG 139 obliges FOS to identify, seek to resolve and report to ASIC on complaints, systemic issues and serious misconduct. A 'systemic issue' affects people beyond the parties to the dispute.<sup>29</sup> 'Serious misconduct' is conduct that may be fraudulent, grossly negligent or involves wilful breach of applicable laws.<sup>30</sup> The FOS reports quarterly to ASIC on systemic issues and serious misconduct relating to the previous quarter, with the names of financial services providers involved generally remaining anonymous. Each quarter FOS also meets with ASIC to discuss individual cases.

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26 FOS, 'Terms of Reference', p. 2.

27 Mr John Price, Ombudsman General Insurance, Financial Ombudsman Service, *Committee Hansard*, 15 September 2011, p. 1.

28 FOS, 'General Insurance Code of Practice – Overview of Year 2009/2010', Appendix A.

29 FOS, 'Terms of Reference', p. 22.

30 FOS, 'Terms of Reference', p. 22.

- 2.46 Whereas FOS is expected to address the merits of individual complaints, ASIC acts only where widespread public detriment is present, but FOS assists ASIC by sharing information. In this way, the two organisations are intended to act as a holistic and mutually supporting regulatory check on the insurance industry.