

New Corporate Governance for the Australian Insurance Industry

A number of dramatic changes.

The Australian insurance industry has recently experienced a number of dramatic changes. In recent years it has felt the effects of the legislative and regulatory reform resulting from the high profile collapse of the HIH group in 2001 with a deficit of claims as against the provisions made of up to Aus\$5.3 billion. The Royal Commission Report in 2003 found that mismanagement and poor corporate governance were largely to blame.

The fallout from HIH continues with ongoing high profile disqualifications and convictions. Following the demise of HIH, there has been a marked increase in regulation, with consumer protection a key objective.

Correspondingly, there have been questions as to the cost of compliance and the knock-on effect on the affordability of insurance. A sense of balance and proportionality is slowly returning to the sector. Notably, the Australian regulatory bodies have gone so far as to modify previous proposals for the prudential supervision of insurance groups in response to industry concerns about the amount of work involved with compliance.

Nonetheless, corporate governance remains high on the agenda for Australian regulatory bodies. Directors' duties are under close scrutiny; the extent to which senior management below board level should incur personal duties and liabilities is also on the radar following a report by the Corporations and Marketing Advisory Committee in June 2006.

The Australian insurance industry has a new Code of Practice, new standards for decision makers and new standards on corporate governance, all outlined below.

Fit and proper standards for insurance company decision makers

From 1 October 2006, insurers must have in place a fit and proper policy that meets the new Prudential Standard issued by the Australian Prudential Regulation Authority (APRA) (GPS 520 Fit and Proper).

- The insurer must implement a written fit and proper policy;
- The fitness and propriety of a 'responsible person' must generally be assessed before their appointment and reassessed as close to annually as practicable;
- An insurer must take all prudent steps to ensure that a person is not appointed to, or does not continue to hold, a 'responsible person' position for which they are not fit and proper.

The standard is aimed at senior managers - anyone playing a significant role in the management or control of the regulated institution, or involved with services or support which are prudentially significant. Each insurer must document the competencies required for each 'responsible person' position. That person's characteristics must include competence, diligence, honesty, integrity, judgement to perform properly the duties of the 'responsible person' a position free from conflict of interest.

One aim of the standard is to identify behaviour which constitutes grounds to disqualify that senior manager from continuing in that role under the statutory framework that applies to insurers in Australia.

Significantly, the fit and proper policy must include adequate provision to allow whistle blowing if anyone believes that a responsible person does not meet the insurer's fit and proper criteria. The insurer (and any of its subsidiaries) must ensure that it does not have

an internal policy or contractual arrangement which explicitly or implicitly restricts or discourages communication by a notifying person to APRA.

Corporate Governance for insurers

From 1 October 2006, life insurers, general insurers and authorised deposit taking institutions (ADIs) are required to comply with APRA's new Prudential Standard on corporate governance (GPS 510 Governance).

While there has been much debate in Australia in relation to the new obligations, what is set out is really no more than good practice that should already be followed by insurers.

The key features of the Standard include:

- Who can sit on a board: boards must contain a minimum of five directors. The majority must, at all times, be independent directors. Directors and senior management are required collectively to hold the full range of skills needed for the effective and prudent operation of the regulated institution. Each director must have the skills to allow him or her to make an effective contribution to the board's deliberations and processes
- Independent directors: an independent director is defined as a non executive director, i.e. someone who is not a member of management, who is free from any business or other association that could materially interfere with the exercise of his or her independent judgement.

The performance of the board and of individual directors must be assessed annually. This requires setting the board's objectives, such as establishing an overall strategy for the regulated institution, and assessing operating and financial conditions against forecasts or making key decisions in a timely manner.

New Insurance Code

The new general insurance Code of Practice covering the Australian insurance industry was introduced on 18 July 2006.

The code aims to raise service standards, improve claims and complaints handling and help customers to gain a better understanding of how general insurance works. The code is not intended to represent a new way of doing business, but simply to formalize the insurer's current approach to the handling of claims.

The code covers nearly all types of general insurance business and is different from the previous code. It places on insurers a number of minimum requirements which include:

- Meeting set timetables for handling claims or responding to complaints
- Fast tracking claims or making advance payments to customers with financial hardship
- Giving reasons for a decision not to provide cover and referring applicants to a different insurer for information about insurance options available. If the applicant is unhappy with the decision, the insurer must provide the applicant with information about its complaints handling procedure
- Accepting responsibility for the quality of workmanship and materials used by a repairer authorised by the insurer
- Establishing internal processes for responding to catastrophes and disasters. In this regard, the code seeks to take compassionate considerations into account
- Providing up-to-date and clear information to the community to assist it in understanding how insurance works

The code is voluntary and applies on an opt-in basis. It covers all general insurance products except workers' compensation, medical indemnity insurance, compulsory and third party insurance and marine insurance. It does not apply to life and health insurance products issued by life insurers or registered health insurers, or to reinsurance. A key extension in the application of this code is that it extends to insured businesses as well as insured individuals.

Responsibility for the new code has been granted to the Insurance Ombudsman's Service (IOS) which monitors compliance with the code and receives complaints about insurers.

If the insurer still fails to implement such a plan and correct the breach, the IOS has the authority to report the matter to the Code Compliance Committee (CCC). The CCC has the power to impose sanctions which may comprise corrective action within a specified time frame, such as a compliance audit or corrective advertising. Alternatively it might require publicity of the issue of non compliance. Decisions by the CCC are binding on all insurers that have adopted the new Code.

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