



GEOFF SUMMERHAYES

Member

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LIFE INSURANCE CLAIMS OVERSIGHT AND GOVERNANCE: APRA REVIEW OF RESPONSES TO INFORMATION REQUEST

Thank you for responding to APRA's 4 May 2016 information request on claims oversight and governance¹. Boards were asked to provide information on how the company:

- engages with trustees, ensures alignment between themselves and trustees and reflects claims philosophy in claims handling;
- assesses claims fairly and in accordance with the policy terms, including how complaints are managed²;
- reviews the suitability of policy terms and benefit definitions and implements changes when necessary; and
- reviews culture and remuneration arrangements impacting on claims staff and their decisions.

Appropriate claims management processes are critical to the sound operation of an insurer, and are regularly assessed by APRA as part of prudential supervision. Over the past several years, APRA has had a heightened focus on these matters, particularly in the group insurance market, in response to losses made by insurers as a result of poor risk management and governance practices³. APRA's recent submission to the Senate Standing Committee on Economics and ASIC's forthcoming review of life insurance claims demonstrate the heightened regulatory focus on life insurance practices⁴.

We have considered the information provided in insurers' responses to our information request, and a summary of key themes from these submissions is attached. The purpose of this summary is to inform insurers and interested parties of what entities are doing to ensure claims processes and governance are effective and to identify where further work is needed

¹APRA (4 May 2016), *Letter to Chairs of APRA-registered Life Insurers*
<http://www.apra.gov.au/lifs/Documents/1605-Letter-industry-LI-Claims-Oversight-Governance.pdf>.

²Section 48 of the *Life Insurance Act 1995*.

³APRA (18 May 2015) *Letter to Life Insurers on Group Insurance*.
<http://www.apra.gov.au/lifs/Pages/Letter-to-LI-entities-on-Group-Insurance-18-May-2015.aspx>.

⁴ APRA 2016, *APRA submission: Inquiry into the scrutiny of financial advice - Life Insurance*,
http://www.apra.gov.au/Submissions/Pages/16_01.aspx.

to meet APRA's expectations. In addition, broader cross-industry work by APRA on risk culture will be published shortly and will be relevant to insurers.

APRA has identified a number of areas where insurers could improve practices to better meet expectations. These are:

- reviewing insurance benefit design and definitions with a stronger focus on delivering insurance benefits appropriate for members at an appropriate level of cost;
- better sharing of information between insurers and trustees. For example, information that could be shared more readily includes claims data and trends, and regular reporting on key performance indicators (KPIs);
- closer co-operation and alignment between trustees, insurers and reinsurers to optimise outcomes for beneficiaries; and
- clarifying the approach to claims in the claims philosophy of both the insurer and trustee to improve claimants' understanding of how claims will be managed.

Many insurers told us that they have projects underway to improve claims processes and claims handling, and also address benefit design. APRA is monitoring the progress of these reviews, along with the governance processes around these changes, and expects key risks, including legal risk, to be recognised and actively addressed. Reviews of claims processes should focus on how valid claims can be paid as quickly as possible, while being vigilant to identify instances where claims processes result in inappropriate outcomes for claimants and rectify them.

APRA will continue to work cooperatively with ASIC as each agency conducts its review activity in accordance with its mandate. APRA's review of responses focused on governance and risk management of claims systems and processes by insurers, whereas ASIC's forthcoming review of life insurance claims is focusing on the treatment of individual claimants consistent with its conduct mandate. Nevertheless, to the extent that any findings from ASIC's report have prudential implications, APRA will follow up with the relevant insurers to monitor the progress of any remediation activities. Where APRA is not satisfied with progress, it may consider taking supervisory actions such as requiring formal board-approved remediation plans, regular reporting to APRA or other measures to address deficiencies and mitigate heightened conduct and operational risks.

APRA is not seeking any further formal response from insurers at this stage, however we recommend that your board consider the content of this letter and, where appropriate, address areas for improvement. Any specific findings concerning your organisation will be followed up by your responsible supervisor separately to this letter.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Geoff Summerhayes', written in a cursive style.

Geoff Summerhayes
APRA Member



LIFE INSURANCE CLAIMS OVERSIGHT AND GOVERNANCE: APRA REVIEW OF RESPONSES TO INFORMATION REQUEST

Summary of key themes

APRA reviewed insurers' responses which outline each insurer's overall approach and framework for claims; how these frameworks support boards fulfilling their governance responsibilities; and what particular actions boards are taking or planning to take. APRA did not seek more detailed information to verify responses as that will form part of ongoing supervisory activities. If necessary, supervisors will undertake further inquiries or reviews of individual insurers to follow up on any specific matters arising from the responses.

APRA's questions focused on oversight and governance arrangements associated with claims processes and did not consider specifically the conduct of insurers towards individual claimants. As industry is aware, ASIC is currently reviewing the conduct of life insurers with respect to individual claims and expects to release its report shortly. APRA will continue to work with ASIC openly and cooperatively on the matters discussed in this letter.

The main topics of APRA's information request were:

1. Engagement and alignment between life insurers and trustees, including how claims philosophy is reflected in claims handling;
2. Assessing claims fairly and in accordance with the policy terms⁵, including how complaints are managed;
3. How the suitability of policy terms and benefit definitions is reviewed and changes implemented; and
4. How culture and remuneration arrangements impact on claims staff and their decisions.

The findings for each topic are detailed below.

A similar information request was sent to APRA-regulated RSE licensees on 11 May 2016; a separate letter outlining the key findings from APRA's analysis of their responses has also been released today. The key themes and areas for improvement are broadly similar across the two reviews.

1. Engagement and alignment between life insurers and trustees, including how claims philosophy is reflected in claims handling.

APRA considers that active dialogue between insurers and trustees builds trust between parties. Given this, APRA encourages insurers and trustees to discuss in detail proposed changes of approach before they are implemented. In addition, the claims management processes of an insurer must align to a long term sustainable claims philosophy⁶. This expectation is reflected in *Prudential Standard SPS 250 Insurance in Superannuation* (SPS 250) and *Prudential Practice Guide LPG 270 Group Insurance Arrangements* (LPG 270).

The requirement for a trustee to review an insurer's claims philosophy was introduced in SPS 250 and was intended to focus trustees and insurers on aligning how beneficiaries' claims

⁵Section 48 of the *Life Insurance Act 1995*.

⁶ APRA (18 May 2015), *Letter to Life Insurers on Group Insurance*.

<http://www.apra.gov.au/lifs/Pages/Letter-to-LI-entities-on-Group-Insurance-18-May-2015.aspx>.

would be handled⁷. In addition, LPG 270, assists insurers' understanding of the implications of SPS 250 for their operations and outlines APRA's minimum expectations and recommended good practice for an insurer's claims philosophy⁸.

LPG 270 notes that an insurer's claims philosophy must capture the insurer's current approach to claims assessment, administration and settlement. This includes its expectations of claimants (e.g. in respect of the burden of proof of disability), the nature of support given to claimants, processes to be followed by the claimant and communication with the claimant. APRA also expects the insurer's claims philosophy to be clearly articulated.

Key themes from responses

Responses indicated that insurers have a claims philosophy in place which is shared between trustees and insurers. In the case of reinsurers, claims philosophies are generally provided to their insurance partners and sometimes to trustees. Several insurers monitor and update their claims philosophy in parallel with broader work on claims improvement, product design and redesign of customer interfaces. The responses note that reinsurers and insurers work together to align their claims philosophies. That said, there is scope for reinsurers and trustees to increase their engagement.

In some instances it appears that the claims philosophy is broad and may not be sufficiently articulated to enable the superannuation fund trustee to understand the insurer's practical application of definitions. For example, some claims philosophies use a generic statement to the effect that all valid claims will be paid or claims will be paid when all relevant documentation is received. In these cases, it is unclear from the claims philosophy how the insurer would define 'valid' in practice.

However, the lack of clarity found in some claims philosophy statements may be mitigated by the regular interaction between trustees and insurers. As noted earlier, a trustee reviews an insurer's claims philosophy at the time of a group insurance contract tender or renewal. Insurers advised that once the policy is in place, there is regular engagement between insurer and trustee. Insurers also advised that there is regular reporting and reviews to ensure better alignment of expectations. For example:

- regular reporting on the operation of the insurance contract typically is provided to both the insurer and trustee to monitor effectiveness;
- insurers meet with trustees to review claims outcomes; and
- some reinsurers meet with trustees and review claims philosophy and the reinsurer's role, often in conjunction with the insurer.

APRA's assessment of responses

Trustee engagement practices across the industry appear to be improving as all parties see value in closer relationships and stronger understanding between the parties to improve claimant outcomes. However, engagement between insurers and trustees for group

⁷ Prudential Standard SPS 250 Insurance in Superannuation

<http://www.apra.gov.au/Super/PrudentialFramework/Documents/Final-SPS-250-Insurance-in-Superannuation-November-2012.pdf>.

⁸ Prudential Practice Guide LPG 270 Group Insurance Arrangements

<http://www.apra.gov.au/lifs/PrudentialFramework/Documents/Prudential-Practice-Guide-LPG-270-Group-Insurance-Arrangements-October-2014.pdf>

insurance varies in its intensity depending on the nature of the contractual arrangements in place. Typically, insurers meet with trustees on a regular basis, however, the level of interaction with trustees is less frequent for reinsurers. The level and quality of engagement between trustees, insurers and reinsurers on claims outcomes and improvements to insurance arrangements needs to increase with a view to building trust, and in particular a shared understanding of claims philosophy and expectations for the claims handling approach.

In addition, insurers should work more closely with trustees to improve the scope and clarity of claims philosophies. Many claims philosophies are broad in nature and do not set out adequately how an insurer will approach claims. Clarifying, and better communicating to claimants, the approach of both the insurer and trustee to claims is likely to improve claimants' understanding of how claims will be managed.

2. Assessing claims fairly and in accordance with the policy terms, including how complaints are managed

APRA's view is that insurers must assess claims fairly and in accordance with the policy terms in order for the board to be confident that the life company is meeting its obligations under section 48 of the *Life Insurance Act 1995*. In addition, the claims philosophy needs to reflect the insurer's current approach to dealing with claims⁹. Paragraphs 7 to 9 of LPG 270 outline the factors relevant to developing a claims philosophy that APRA considers good practice (see Section 3 below). Given this, effective monitoring and review processes are needed by insurers.

Key themes from responses

Most insurers have regular reporting and review of claims payment rates and complaint trends. This reporting and review includes:

- reporting to the board on large and disputed claims;
- engaging internal and external audit teams to review claims management and control processes; and
- participating and learning from the outcomes of reinsurer's claims reviews to improve sustainability.

The responses indicate that it is common for insurers to have a claims review committee. This committee typically reviews all claims where a complaint has been lodged or where a declined claim is subject to external review. In addition, many insurers reported that they have a feedback process whereby lessons learned from disputed claims are considered, with a view to identifying how internal processes can be improved. For group insurance contracts, operational staff from insurers and trustees typically meet regularly to discuss declined or disputed claims.

Responses also indicated that the recent media focus has increased the level of review and monitoring of claims management, experience and complaints. In some cases there have been changes to the nature and frequency of monitoring, with heightened board or board committee involvement at some insurers.

⁹ APRA (18 May 2015), *Letter to Life Insurers on Group Insurance*
<http://www.apra.gov.au/lifs/Pages/Letter-to-LI-entities-on-Group-Insurance-18-May-2015.aspx>

APRA's assessment of responses

Periodic independent reviews of insurer's current claims management is good practice and APRA expects insurers to continue these reviews. Carrying out independent reviews generally leads to more robust claims monitoring and complaint management processes. Increased scrutiny of claims management processes is also likely to identify opportunities to improve the experience for claimants and APRA welcomes insurers' heightened interest in this aspect of their operations.

Insurers and trustees should be sharing information such as claims data and trends and regular reporting on KPIs. Routine sharing of this type of information between insurers and trustees will help improve insurance arrangements and is likely to assist with delivering a better experience for claimants.

3. Suitability of policy terms and benefit definitions is reviewed and changes implemented

As noted in APRA's 2015 Annual Report, APRA considers that modernisation of benefit design and structures, while taking into account statutory and prudential requirements, is critical to developing sustainable insurance products and should occur as soon as practicable¹⁰. Given this, insurers need an immediate plan for the review and development of insurance policy terms, benefits and definitions. Part of that program of review should include ongoing monitoring of claims so insurers can detect early shifts in claims patterns and respond appropriately and pro-actively. In addition, insurers can undertake more specific reviews when needed to focus on addressing specific issues. For example, reviewing claims processes in response to recent consumer concerns regarding claims.

Key themes from responses

In their submissions, insurers indicated that they have ongoing monitoring processes to determine how product terms and benefit definitions operate in practice. The impact of product terms is typically reported to boards or board committees as part of regular business performance reporting. In some instances, the annual Financial Condition Report (FCR) contains analysis of and commentary on the impact of particular benefit definitions and suggests opportunities for change. In addition, group insurers are prompted by regular tendering for the provision of insured benefits in superannuation to review product design, including benefit definitions.

The poor profitability experienced in group insurance gave significant impetus to the regular reviewing and monitoring of product benefits and design¹¹. In light of this, many insurers are reviewing claims processes and developing early claim management interventions to promote early return to work. This approach seeks to focus on the wellbeing of members by assisting a return to work. Insurers have told us that the higher costs of more intervention in the claim process is more than offset by the reduced claim duration and cost.

¹⁰ APRA 2016, *APRA submission: Inquiry into the scrutiny of financial advice - Life Insurance*, http://www.apra.gov.au/Submissions/Pages/16_01.aspx

APRA 2015, *Annual Report and Financial Statements year ending 30 June 2015*. <http://www.apra.gov.au/AboutAPRA/Publications/Pages/ar2015-single.aspx>

¹¹ APRA (3 March 2015), *Speech by Ian Laughlin A challenge to the life industry: managing for long term portfolio health*, <http://www.apra.gov.au/Speeches/Pages/Life-Risk-Insurance-A-challenge-to-the-life-industry-managing-for-long-term-portfolio-health.aspx>

Some insurers have undertaken further reviews of product definitions (for existing in-force business) and claims practices as a result of recent public and regulator attention. This includes a focused review of technical medical aspects such as trauma definitions, including heart attack. In most cases insurers reported engaging Chief Medical Officers to assist in such reviews. Insurers also reported involving internal audit, external consultants, the Appointed Actuary and claims and underwriting staff in reviewing policy definitions and related claims management practices. APRA noted that reinsurers are also offering assistance and expertise to their insurers in undertaking reviews of policy definitions.

APRA's assessment of responses

Reviews of design and definitions need to focus on delivering insurance benefits appropriate for members at an appropriate level of cost, rather than focusing on reducing costs to improve insurer profitability without adequately considering member needs. As noted in our 27 April 2016 submission to the Senate Economics Committee and 2015 Annual Report, industry needs to do more to ensure the medical definitions used in insurance products are updated¹². The responses show that regular reviews and reporting of the impacts of definition changes is occurring and is reported to boards, however it appears that some reviews have been prompted more by poor profitability and negative media coverage. APRA expects insurers to continue to review their definitions and make improvements to insurance product design, terms and conditions where appropriate to incorporate lessons learned.

4. Developing a culture that achieves fairness in the assessment of claims.

The risk culture of an organisation reflects the influence of organisational culture on how risks are managed. The approach to claims assessment and management is an indicator of risk culture.

Prudential Standard CPS 220 Risk Management (CPS 220) requires boards of insurers to form a view of the risk culture in the institution and the extent to which that culture supports the ability of the institution to operate consistently within its risk appetite, identify any desirable changes to the risk culture and ensure the institution takes steps to address those changes¹³. Given this, APRA is interested in how insurers are implementing and complying with this element of CPS 220 with respect to claims processes.

Ensuring appropriate remuneration structures are in place is an important aspect of risk culture. Remuneration is a significant factor in driving risk behaviour within financial institutions and has been an area of focus for international regulators since the global financial crisis. As a result, APRA introduced various prudential requirements in relation to remuneration¹⁴. The requirements are designed to ensure remuneration arrangements promote prudent risk-taking in the management of the business; and that there is effective governance of remuneration matters.

¹² APRA 2015, *Annual Report and Financial Statements year ending 30 June 2015*
<http://www.apra.gov.au/AboutAPRA/Publications/Pages/ar2015-single.aspx>.

¹³ The new standard harmonises risk management requirements across the banking and insurance industries, bringing together a range of risk management requirements into a single standard. APRA (4 December 2014), *APRA releases final prudential standard and prudential practice guide on risk management*, Media release 14.29
http://www.apra.gov.au/MediaReleases/Pages/14_29.aspx

¹⁴ APRA (30 November 2009), *APRA finalises position on remuneration*
http://www.apra.gov.au/MediaReleases/Pages/09_38.aspx.

Key themes from responses

Insurers view culture as setting the tone for staff in their day-to-day work including interactions with, and decisions affecting, beneficiaries. In many cases insurers have been reviewing their culture and approach to claims management. This activity has taken place in parallel with various reviews in response to the recent media focus on claims management; and also often forms part of broader work on culture.

Examples of actions insurers have taken include:

- refocusing staff surveys to gain better insights into how staff perceive the company and their role in it;
- workshops and other interactive sessions with staff to more closely explore and align culture, values and ethics and how these reflect and support the insurer's strategy and desired approach to dealing with beneficiaries including claimants;
- conducting more detailed surveys of claimants' experiences and perceptions arising from their dealings with the insurer - this also includes more direct contact with customers to understand their experiences in greater depth; and
- using external experts to assist in the above, including aligning staff attitudes in terms of their interactions with customers - in particular claimants.

In many cases work to date on an insurer's culture has occurred over several years and is continuing, with most responses acknowledging that while progress has been made there is still much work to do. Further work to be undertaken by insurers includes obtaining a holistic view of culture across the entire business; embedding appropriate culture and aligned behaviours; and the development and implementation of support tools and metrics. Alongside these changes many insurers are reviewing their claims oversight and governance, partly in response to adverse claims experience in recent years and also in response to recent publicity.

A limited amount of detail was provided in the responses with respect to remuneration arrangements for claims staff. Most insurers told us that their overall remuneration policies were applied consistently to claims staff as for all other staff. Detailed performance and measurement criteria varied across insurers and in most cases were not set out in detail in the responses. That said, a number of insurers stated that claims staff were not incentivised to decline claims. Instead claims staff typically received fixed remuneration, in some cases with incentives that are based on performance metrics aligned to claims assessment quality and service level.

APRA's assessment of responses

APRA notes that culture is now firmly on the agenda of boards and senior management. The responses showed that life insurers take seriously the need to engender an appropriate risk culture as a critical element in sustainable success and attaining appropriate outcomes for beneficiaries. In addition, the boards of all insurers seem committed to defining, embedding and measuring a sound risk culture that is reflected in their claims philosophy and in line with CPS 220. APRA will continue to engage boards and senior management as to their progress on this important endeavour.

APRA's broader cross-industry work on risk culture will be published as an information paper shortly. The paper summarises current industry practices in relation to risk culture that APRA has observed across the insurance, authorised deposit-taking institution and

superannuation industries. The paper reflects APRA's current thinking on risk culture and will be relevant for all insurers.

In terms of remuneration, it is unclear to APRA whether remuneration structures have resulted in adverse claims outcomes for claimants. Given this, APRA intends to explore in more detail the specifics of how remuneration and performance is assessed for claims and more senior staff to ensure that incentives for inappropriate claims outcomes or risk taking are not created.

Overall findings

In most cases, insurers have described appropriate governance structures, and indicated that adequate reporting is in place so that both boards and senior management are well informed. In many cases, these arrangements have been reviewed and enhanced in recent times. The details of such arrangements vary across institutions due to individual entity differences (such as size, complexity, and the nature of the business they undertake).

APRA has, however, identified a number of areas where insurers could improve practices to better meet expectations. These are:

- better sharing of information between insurers and trustees. For example, information that could be shared include claims data and trends and regular reporting on KPIs;
- closer co-operation and alignment between trustees, insurers and reinsurers to optimise outcomes for beneficiaries;
- regular reviews of product design and definitions with a stronger focus on delivering insurance benefits appropriate for members at an appropriate level of cost; and

clarifying the approach to claims in the claims philosophy of both the insurer and trustees to improve claimants' understanding of how claims will be managed.