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Deputy Chairman

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To the Chairs of RSE licensees

RSE LICENSEE CLAIMS OVERSIGHT AND GOVERNANCE: APRA REVIEW OF RESPONSES TO INFORMATION REQUEST

On 11 May 2016, APRA sent an information request on claims oversight and governance under group insurance arrangements to a selection of 25 (mainly larger) RSE licensees. RSE licensee boards were asked to provide information on their oversight and management of claims under group insurance arrangements, including how they:

- engage with life insurers, ensure alignment between themselves and life insurers and reflect claims philosophy in claims handling;
- assess claims fairly and in accordance with the policy terms, including how complaints are managed;
- review the suitability of policy terms and benefit definitions and implement changes when necessary; and
- review culture and remuneration arrangements impacting claims staff and their decisions.

Appropriate claims management processes are a critical component of the governance and oversight of an RSE licensee's insurance arrangements, 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 practices.¹ 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 practices.²

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

¹APRA (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>.

² APRA 2016, *APRA submission: Inquiry into the scrutiny of financial advice – Life Insurance*,

http://www.apra.gov.au/Submissions/Pages/16_01.aspx.

needed 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 RSE licensees.

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

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

APRA observes that some RSE licensees are already working with their insurers to address insurance benefit design and claims management challenges, and a number of life insurers also have projects underway to improve claims processes and claims handling. APRA is closely monitoring the progress of these activities, 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.

Group insurance arrangements, including claims oversight and governance practices, remain an area of heightened focus for APRA and we expect industry practices to continue to evolve and improve over time. We are not seeking any further formal response from RSE licensees at this stage, however recommend that your board consider the content of this letter and, where appropriate, address areas for improvement in consultation with your insurer(s). Any specific findings concerning your organisation will be followed up by your responsible supervisor separately to this letter.

Yours sincerely

A handwritten signature in cursive script that reads "Helen Rowell".

Helen Rowell



RSE LICENSEE CLAIMS OVERSIGHT AND GOVERNANCE: APRA REVIEW OF RESPONSES TO INFORMATION REQUEST

Summary of key themes

On 11 May 2016, APRA sent an information request on claims oversight and governance under group insurance arrangements to a selection of 25 (mainly larger) RSE licensees. The RSE licensees' responses outlined:

- their overall approach and framework for dealing with claims under group insurance arrangements;
- how these frameworks support boards fulfilling their governance responsibilities; and
- particular actions boards are taking or planning to take to enhance claims oversight and governance practices.

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 RSE licensees 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 RSE licensees and 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 cooperatively on the matters covered in this letter.

APRA's request sought information from RSE licensees about how they:

1. engage with life insurers, ensure alignment between themselves and life insurers and reflect claims philosophy in claims handling;
2. assess claims fairly and in accordance with the policy terms, including how complaints are managed;
3. review the suitability of policy terms and benefit definitions and implement changes where necessary; and
4. review culture and remuneration arrangements impacting claims staff and their decisions.

The findings for each topic are detailed below.

A similar information request was sent to APRA-regulated life insurers on 4 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 RSE licensees and life insurers, including how claims philosophy is reflected in claims handling

Prudential Standard SPS 250 Insurance in Superannuation (SPS 250) requires an RSE licensee to give due consideration to claims philosophy in selecting and reviewing its insurance arrangements. An insurers' claims philosophy establishes clear expectations about the insurer's approach to the assessment, administration and settlement of claims, including

the processes claimants need to follow and the support given to claimants (and, where relevant, beneficiaries).

The requirement in SPS 250 for an RSE licensee to review an insurer's claims philosophy was intended to focus RSE licensees and insurers on aligning how beneficiaries' claims would be handled. In addition, APRA released *Prudential Practice Guide LPG 270 Group Insurance Arrangements* (LPG 270) to assist 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 philosophy.³

An insurer's claims philosophy is a reflection of its ability and willingness to assess and pay legitimate claims expeditiously. The claims management processes of an insurer should therefore align to its claims philosophy; it is important that these be established with a view to sustainability over the long term. With an increasing focus on assisting members to return to work after a period of disability, the claims philosophy should make clear to RSE licensees and members the approach the insurer can be expected to take in dealing with disability claims. In particular, it is important that an RSE licensee be able to understand the insurer's practical application of the definition of disablement.

Key themes from responses

Responses indicated that insurers shared their claims philosophies with RSE licensees, allowing RSE licensees to give consideration to claims philosophy when selecting and reviewing their insurance arrangements and during tender and re-tender processes. Regular meetings also take place between representatives of RSE licensees and insurers where elements of the insurer's claims philosophy are discussed, particularly 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, responses recognised that there is scope for RSE licensees and reinsurers to increase their engagement.

In some instances, the claims philosophy appeared broad and not sufficiently articulated to enable the RSE licensee 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 regular interaction between RSE licensees and insurers. Responses noted that, in addition to the review of an insurer's claims philosophy undertaken by RSE licensees at the time of a group insurance contract tender or renewal, typically there is regular engagement on claims philosophy between both parties once a policy is in place. RSE licensees 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 the RSE licensee to monitor effectiveness;

³ APRA (October 2014), *Prudential Practice Guide Group Insurance Arrangements LPG 270*, <http://www.apra.gov.au/lifs/PrudentialFramework/Documents/Prudential-Practice-Guide-LPG-270-Group-Insurance-Arrangements-October-2014.pdf>

- insurers meet with RSE licensee representatives and, in some cases more recently, with the RSE licensee board to review claims outcomes; and
- some reinsurers meet with RSE licensees and review claims philosophy and the reinsurers' role, often in conjunction with the insurer.

Responses noted, for example, that administration staff regularly discuss process matters, while less frequently there is discussion between more senior executives on claims data and trends and options for improving the insurance arrangement and procedures. Topics for discussion can include establishing, documenting and operationalising key aspects of the insurance arrangement including service standards, underwriting and claims management philosophy

APRA's assessment of responses

RSE licensee-insurer engagement practices across the industry appear to be improving as all parties see value in closer relationships and stronger understanding to improve claimant outcomes. However, engagement between RSE licensees and insurers for group insurance varies in its intensity depending on the nature of the contractual arrangements in place. Typically, RSE licensees meet with insurers on a regular basis, however, the level of interaction with reinsurers is less frequent.

The level and quality of engagement between RSE licensees and insurers 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 claims handling approach. In addition, RSE licensees should work more closely with, and where necessary challenge, their insurers 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 to claims of both the insurer and RSE licensee is likely to improve a claimants' understanding of how claims will be managed. APRA also encourages RSE licensees and insurers to discuss in detail proposed changes to claims philosophy and claims handling approach before they are implemented.

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

Under SPS 250, an RSE licensee must ensure it has sufficient and appropriate resources to manage and monitor its relationship with an insurer at all times. This includes a process for regular monitoring of performance under the insurance arrangement, with reporting to senior management against service levels.

Insurers have obligations under section 48 of the *Life Insurance Act 1995* to assess claims fairly and in accordance with the policy terms.

Key themes from responses

Most RSE licensees indicated that they receive regular reporting from their insurers in relation to claims in progress, settled claims, declined claims and complaints, with the majority of reporting occurring either monthly or quarterly. A small number of RSE licensees have access to 'real-time' monitoring / reporting of claims from their insurer. The degree of granularity of reporting varies by RSE licensee, with opportunities for improvement self-identified in some cases.

Many RSE licensees have designated operational level insurance representatives who meet regularly with their insurers to cover claims outcomes, declined claims and trends, with escalation frameworks to determine insurance-related matters to be raised with the board or a board committee. In general, large or disputed claims and claims the subject of external dispute resolution or legal action are usually reported to the board or board risk committee.

The majority of RSE licensees self-assessed their oversight of insurance complaints as satisfactory, although areas for improvement in relation to the timeliness and quality of reporting from and follow-up with insurers were identified in a small number of cases.

Certain RSE licensees noted that additional review processes have been put in place in relation to their insurers, including engagement of internal audit teams to review claims management and control processes; as well as external reviews, including by reinsurers. The latter involves reinsurers regularly reviewing cedants' claims and sharing outcomes with insurers (and, in some cases, with RSE licensees) in order to drive improvements.

Responses also indicated that recent media focus has increased the level of review and monitoring of claims management, claims data and trends 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 RSE licensees and insurers.

APRA's assessment of responses

Periodic independent reviews of insurers' current claims management is good practice and APRA expects RSE licensees to obtain an understanding of the outcomes of 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 throughout these processes. RSE licensees should also consider undertaking periodic reviews of their own claims management processes, including their alignment and effective interaction with those of the insurer.

All insurers and RSE licensees 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 RSE licensees will help improve insurance arrangements and is likely to assist with delivering a better experience for claimants. To this end, we would encourage RSE licensees to seek greater strategic insights from insurance reporting and monitoring to support this, building upon the current focus on operational matters.

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 practicable.⁴ Given this, APRA encourages RSE licensees to work collaboratively with insurers to review policy terms (including insurance benefit design) and benefit definitions on a regular basis. Part of that program of review should include ongoing monitoring of claims so RSE licensees and

⁴ <http://www.apra.gov.au/AboutAPRA/Publications/Pages/ar2015-single.aspx>

insurers can detect early shifts in claims patterns and respond appropriately and proactively.

Key themes from responses

Responses from RSE licensees in relation to reviews of the suitability of policy terms and benefit definitions were varied. Although the majority of RSE licensees outlined a regular program of review, undertaken either in collaboration with their incumbent insurer or with an insurance consultant (perhaps as a pre-cursor to a tender exercise), a minority of RSE licensees had not recently undertaken a formal review of insurance benefit design. In the vast majority of cases, benefit design is considered and implemented at the time of insurance contract renewal, although a small number of RSE licensees identified moves towards more regular review with their insurer.

RSE licensees indicated awareness of insurers' reviews of product definitions and claims practices as a result of the recent media commentary and several RSE licensees have embarked upon reviews linked to this activity.

APRA's assessment of responses

While APRA welcomes the review of insurance policy terms, benefit design and definitions that has occurred, it appears that much of the current focus on reviews has been substantially prompted by recent poor claims experience for insurers putting pressure on premiums, and also negative media coverage.

Insurers and RSE licensees should work together on an ongoing basis to continue to review the insurer's definitions and make improvements to insurance arrangements where appropriate to incorporate lessons learned. Further, reviews of design and definitions should focus on delivering sustainable insurance arrangements that meet members' needs at an appropriate cost, rather than having undue focus on offering maximum benefits for lowest cost or improving insurer profitability.

4. *Developing a risk 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. Ensuring appropriate remuneration structures are in place is also an important aspect of risk culture. Remuneration is a significant factor in driving risk behaviour within financial institutions, including the business operations of RSE licensees and insurers, and has been an area of focus for international regulators since the global financial crises. Inappropriately designed remuneration structures can drive poor behaviour, and this can extend to claims decision-making both at the RSE licensee and insurer level.

Prudential Standard SPS 510 Governance (SPS 510) requires an RSE licensee to establish and maintain a documented remuneration policy, with performance-based components of remuneration required to be designed to encourage behaviour that, amongst other things, supports protecting the interests, and meeting the reasonable expectations, of beneficiaries. There are similar prudential requirements placed upon insurers to ensure remuneration arrangements promote prudent risk-taking in the management of the business and that there is effective governance of remuneration matters.

Key themes from responses

All responses from RSE licensees pointed to established remuneration policies, applied consistently to all staff, including those with claims handling responsibilities. Although only a limited amount of specific detail was provided in the responses with respect to remuneration arrangements for staff with claims handling responsibilities, the majority of RSE licensees self-assessed their remuneration arrangements as sound.

A small number of RSE licensees provided detail on the remuneration arrangements of their insurers, and an understanding of the linkage between performance incentives, risk culture and decision-making as it pertains to claims. In these cases, RSE licensees had typically sought assurance from their insurer that claims staff were not incentivised to decline claims, with incentives primarily based on performance metrics aligned to claims assessment quality and service level.

APRA's assessment of responses

The assessment of the appropriateness of claims handling practices and remuneration arrangements must be considered in the broader context of an entity's risk culture. The responses showed that a number of RSE licensees are cognisant of cultural aspects driving decision-making and some RSE licensees are taking steps to define, embed and measure risk culture as well as to challenge their insurers' practices in this regard. When considered alongside our analysis of life insurance industry responses, APRA's review suggests that it is becoming more common to describe an overarching culture which supports claims oversight and which is also reflected in claims philosophy.

For many RSE licensees, the focus on risk culture is at an early stage relative to progress across other APRA-regulated industries and more work is needed. APRA will continue to engage boards and senior management in discussion as to their progress on this key issue with a view to ensuring continued focus on risk culture and remuneration, in the context of claims management and more broadly.

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 to RSE licensees.

Overall findings

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

- closer co-operation and alignment between RSE licensees, insurers and reinsurers to optimise outcomes for beneficiaries;
- clarifying the approach to claims in the claims philosophy of both the RSE licensee and insurer to improve claimants' understanding of how claims will be managed;
- better sharing of information between RSE licensees and insurers. For example, information that could be shared more readily includes claims data and trends and regular reporting on key performance indicators; and
- reviewing design and definitions with a stronger focus on providing sustainable insurance arrangements that meet member needs at an appropriate cost.

Group insurance arrangements, including claims oversight and governance practices, remain an area of heightened focus for APRA and we expect industry practices to continue to evolve and improve over time. APRA recommends that the boards of all RSE licensees consider the matters raised above and, where appropriate, address areas for improvement in consultation with their insurer(s).