



**MINISTRY OF BUSINESS,
INNOVATION & EMPLOYMENT**
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Approved Dispute Resolution Schemes: Minimum Compensation Cap for Insurance Disputes

Discussion Document
March 2015

Submission Process

Please send submissions in the provided template to corporate.law@mbie.govt.nz by 9 April 2015.

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What is This Paper For?

1. This paper seeks submissions on a proposed increase to the cap on the compensation that dispute resolution schemes can award in relation to disputes about real property insurance claims. The proposed increase is from \$200,000 to a minimum of \$350,000.

Introduction

2. The *Financial Service Providers (Registration and Dispute Resolution) Act 2008* (FSP Act) requires people that provide financial services to retail clients to belong to an approved dispute resolution scheme (a “scheme”). The definition of financial services includes the provision of insurance.
3. Access to a scheme offers significant benefits for clients and for financial services providers, including:
 - a. an independent mechanism for resolving complaints in situations where the client and their financial services provider have not been able to resolve the complaint; and
 - b. an accessible and cost-effective forum for clients to pursue complaints, compared with court proceedings; and
 - c. increased consumer and investor confidence in the financial services sector.
4. Schemes are a less formal, cheaper and faster alternative to the Courts. Complaints are free for clients, and scheme decisions are only binding if accepted by the client. The financial service provider cannot appeal the scheme’s decision.
5. There are four approved schemes at present:
 - a. The Banking Ombudsman Scheme (BOS)
 - b. Financial Dispute Resolution Scheme (FDRS)
 - c. Financial Services Complaints Limited (FSCL)
 - d. The Insurance and Savings Ombudsman (ISO)
6. The jurisdiction of each scheme and the requirements that they place on their members is set out in the rules of each scheme. Scheme rules place a limit on the maximum value of claims they can consider, or the maximum amount of compensation they can award. These rules have been approved by the Minister of Consumer Affairs as being adequate and in compliance with the principles and requirements in sections 52(2) and 63 of the FSP Act. Any changes to these rules also have to be approved by the Minister.
7. The FSP Act, as amended by the *Financial Service Providers (Registration and Dispute Resolution) Amendment Act 2014* on 1 July 2014, allows the Minister of Consumer Affairs to prescribe requirements for the jurisdiction of schemes. It will also allow the Minister to imply a provision (i.e. put a specific rule) into scheme rules. Any scheme rule would have no effect to the extent it was inconsistent with a provision implied into scheme rules.
8. The FSP Act does not apply to the Earthquake Commission (EQC) and it is not a member of a scheme. EQC has an internal complaint process. If EQC customers are not satisfied with the outcome of this process, they can use a free independent mediation service or complain to the Office of the Ombudsman (see <http://www.eqc.govt.nz/about-ecq/make-complaint> for more details).

Dispute Resolution Scheme Claim Limits – Status Quo

9. All of the approved schemes have monetary limits on their jurisdiction that are set out in their rules (the specific relevant rules for each scheme are set out in Annex 1). All of monetary limits are set at \$200,000 and all of the schemes allow for members (i.e. financial service providers) to voluntarily waive this limit.

10. We understand that at present almost all insurers of real property are members of ISO or FSCL. The rules of both ISO and FSCL allow them to consider disputes up to \$200,000 in value. This monetary limit applies to the amount under dispute, rather than the total value of the insurance claim. For the ISO to be able to consider part of a dispute, the whole claim must have been accepted by the insurer and the part under dispute must be no more than \$200,000. For example:

An insurer accepts that a customer has a valid claim to have their house rebuilt. The insurer considers that the cost of the rebuild will be \$500,000. The customer considers the cost of the rebuild will be \$650,000. Both ISO and FSCL would have jurisdiction to consider this dispute because the difference between the amount in dispute – \$150,000 – is less than \$200,000.

11. The other two approved schemes, BOS and FDRS, deal with fewer disputes relating to general insurance. Those that they do consider primarily relate to the distribution of insurance through the banks and through financial advisers.
12. BOS's limit applies to the amount the complainant has claimed (or could reasonably claim) for direct loss, rather than the underlying value of the transaction or the total value of the customer's business with the participant. BOS could therefore also consider the dispute outlined in the scenario above, because the amount in dispute or amount claimed for the loss is \$150,000.
13. Unlike the other schemes, FDRS will consider claims of more than \$200,000 in value, if the complainant waives all rights to the excess portion should the complaint be resolved by FDRS. Whether the scenario outlined above falls within FDRS's jurisdiction will depend on whether the complainant frames the dispute as being about the total value of the claim or just about the difference between their position and that of the insurer.

Problem Definition

14. There are concerns that the \$200,000 cap applied by schemes is acting as a barrier to the efficient resolution of some residential property insurance claim disputes.
15. The Canterbury earthquakes highlighted the potential inadequacy of scheme jurisdiction in this area. The Canterbury Earthquake and Recovery Authority has determined that the average cost of house repairs is approximately \$240,000 per dwelling and that the average cost of a rebuild is approximately \$420,000. These figures relate to claims over \$100,000, known as "over-cap" claims, because claims under \$100,000 are covered by EQC.
16. The High Court is currently the forum in which insurance claims disputes of over \$200,000 can be adjudicated. Clients may not be able to afford the cost of court proceedings (this is discussed further at paragraph 28). Complaints to a scheme are free for clients. Fees paid by an insurer for a complaint to a scheme are significantly less than the costs of court proceedings.
17. The Australian Securities and Investment Commission recently increased the amount of compensation that external dispute resolution schemes, such as the Financial Ombudsman Service, must be able to award from A\$200,000 to A\$280,000. This was based, in part, on a recommendation from the Australian Productivity Commission that these caps should be reviewed on a regular basis, and set at a level that reflects the level of potential detriment facing consumers. Similarly the award limit in the United Kingdom was raised from £100,000 to £150,000 in 2011.
18. The potential for insurers and other financial service providers to change schemes may restrict the ability of schemes to propose changes to their rules that may resolve these issues. Given that schemes are funded by their membership, significant changes that are not in the interests of members may be seen as putting a scheme at a competitive disadvantage. The lifting of minimum requirements for all schemes would allow for appropriate changes to be made and would ensure a level of consistency across schemes.

19. While the issue of the cap may be relevant in relation to other financial services, and other types of insurance, at this point we are only consulting on an amendment to the cap in respect of disputes resulting from real property insurance claims. We will consider issues relating to scheme rules more generally, including caps for other financial services, as part of the broader review of the Financial Advisers Act 2008 (FA Act) and FSP Act, which will commence in the first half of 2015.

Question

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|---|
| 1. Do you agree with this characterisation of the problem? If not, why not? |
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Objective

20. To ensure that when consumers have a dispute with their insurer that there is an efficient, effective and affordable method by which they can resolve this dispute.

Proposal

21. An increase in the level of compensation that schemes can provide in New Zealand could make schemes a more effective mechanism for the efficient resolution of insurance disputes.
22. We have set out below a proposed rule that would be implied into the rules of each scheme, via regulation. We are seeking feedback on the proposed rule as a whole, and on each of its components.
- Proposed rule:*
- a. Any cap applied by a scheme on the compensation that it can award in relation to an insurance claim dispute regarding real property (i.e. buildings or land) must be at least \$350,000.
 - b. This rule applies where the events giving rise to the insurance claim in dispute occurred on or after 16 August 2010.
23. We think that the approach that the schemes take to 'considering the difference' (discussed in paragraph 10) should also apply under any new compensation cap. Therefore we propose that when determining the amount of compensation to be awarded, this should be considered to be the difference between what the insurer thinks the claim is worth and what the customer thinks the claim is worth.
24. We would also appreciate feedback on any other changes that could increase access to the schemes in relation to residential property insurance claim disputes.

Question

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| 2. Do you think the proposed rule is the best way of increasing access to schemes for real property insurance claim disputes? |
| 3. Do you agree that the amount of compensation to be awarded should be the difference between what the insurer thinks the claim is worth and what the customer thinks the claim is worth? |
| 4. Do you have any feedback on any other changes that could increase access to the schemes in relation to residential property insurance claim disputes? |

Type of cap

Rationale

25. We consider that a minimum compensation cap is preferable to setting a limit on the monetary value of a complaint that can be considered. This would allow schemes to consider any complaint regardless of its value, although they could only award compensation up to the value of the compensation cap. In particular, this option is preferable because schemes will not need to spend time and resources determining whether a complaint falls under a particular monetary value.

Question

5. Do you agree that the schemes' cap should be in relation to the amount of compensation they can award, rather than in relation to the value of the dispute? If not, why not?

Amount of the cap

Rationale

26. One consideration in determining an appropriate limit for the cap is the role of schemes under the FSP Act. Schemes are intended to provide an informal, faster and cheaper alternative to the Courts. Complaints are free for clients. Fees paid by a scheme member for a complaint are significantly less than the costs of court proceedings for that member. A scheme's decision is only binding if accepted by the client. The scheme member (i.e. the insurer) cannot appeal the decision.
27. In favour of increasing the limit, the value of residential property is generally high compared to an owner's disposable income. This means that clients may not be able to meet the costs of pursuing the issue through the Courts. In such circumstances, they are unlikely to obtain full redress. To some extent, the existence of lawyers who are willing to take cases on a contingent fee basis improves access to redress in these instances. However, this relies on a solicitor being willing to accept a particular case and does not provide clients with much certainty about access to dispute resolution mechanisms.
28. If the cap limit is set too high there could be increased pressure for schemes to become more like the Courts with consequent implications for formality, speed and cost. For example, for disputes above a certain level, it could be argued that the insurer should be able to appeal decisions, or that formal hearings must be held. A very high cap may also increase pressure on the cost of insurance, if it is seen to increase insurers' potential liability as a result of not being able to appeal scheme decisions.
29. An increase from \$200,000 to \$350,000 aligns with the proposal in the *Judicature Modernisation Bill* to increase the monetary limit of the District Court's civil jurisdiction from \$200,000 to \$350,000. It would also broadly align with the caps in Australia and the United Kingdom, which are approximately set at \$300,000 in New Zealand dollars at current exchange rates.
30. As noted above, the approximate average cost of "over-cap" repairs is \$240,000 and \$420,000 for rebuilds. Given that we propose that the compensation cap can apply to the difference between what the insurer thinks the claim is worth and the customer thinks the claim is worth, we anticipate that the proposal would capture a substantial proportion of disputes for both repairs and rebuilds.

Questions

6. Do you agree with our proposal to increase the minimum compensation cap? What analysis or rationale do you have that supports the cap being at least \$350,000, or higher or lower than \$350,000?
7. Do you consider there to be any risks associated with a cap of at least \$350,000, and if so what are these risks?
8. What, if any, additional costs would be incurred by schemes or their members?
9. How do you think this proposal will affect the numbers of additional disputes that would be considered by these schemes? What is the basis of this view?

Types of disputes covered

Rationale

31. The proposal would apply to disputes related to the insurance of real property in New Zealand. By "real property" we mean buildings or other property permanently attached to land, as well as the land itself. We intend that the proposed minimum compensation cap would cover any disputes relating to the insurance of buildings, but not life, health or other types of property insurance.

32. The proposed rule would also apply to insurance disputes that a consumer might have with an intermediary such as a financial adviser. This may occur, for example, where the consumer has been denied coverage because the intermediary had failed to disclose a matter deemed relevant by the insurer.
33. We do not propose to limit this rule to residential property, due to the time and resources of schemes that would be taken up considering boundary issues around properties that are partially residential. We note that under the FSP Act dispute resolution is not available for businesses with more than 19 full time equivalent employees.
34. As noted above, we anticipate doing a wider review of scheme rules, and their application to other financial services, as part of the review of the FA Act and FSP Act.

Question

10. Do you agree that the minimum compensation cap should only cover real property insurance claim disputes? If not, what other types of disputes should it cover?

Regulatory mechanism

Rationale

35. The proposal would imply the proposed requirement into every scheme's rules using a new regulation-making power in section 79(1) of the FSP Act.
36. Implying a provision into scheme rules would mean that the change to the compensation cap would be effective immediately upon its commencement, without the schemes having to go through any process to change their rules. The downside of this approach is that the amended compensation cap is not necessarily transparent to a member or a complainant reading the schemes' rules. However, this downside could be mitigated by the schemes publicising the implied provision and the increased cap, including on their websites.
37. An alternative approach would be to require schemes to amend their rules to comply with the new requirement. Section 79(1)(cb) allows the Minister to introduce prescribed requirements for the jurisdiction of schemes. Given that the failure to comply with these requirements is grounds for the withdrawal of a scheme's approval, the schemes will need to update their rules in order to comply with this requirement. This approach would be slower than using an implied term, but would provide each scheme with some flexibility as to how it complies and would ensure that the new compensation cap for insurance disputes is transparently incorporated into the scheme's rules.

Question

11. Would it be preferable to introduce this requirement via an implied term, or via a minimum requirement that schemes must amend their rules to meet?

Application of new cap to complaints that are "out of time"

Rationale

38. Scheme rules contain time constraints on the complaints that can be considered by them (e.g. they cannot consider complaints made after two months of the dispute becoming "deadlocked" between the insured and insurer). Given the current limits on what the schemes can consider, a number of current real property insurance disputes that were deadlocked some time ago will not have been considered by a scheme because at that time they were outside of the scheme's jurisdiction.
39. We propose requiring schemes to consider these claims, and apply the proposed new cap to them, if the cause of the event giving rise to the claim occurred on or after 16 August 2010. This is the date that that relevant provisions in the FSP Act about the jurisdiction of schemes came into effect.

Questions

12. Should schemes be able to consider and apply the new cap to some or all complaints that are “out of time”?
13. Is the proposed exception to scheme rules about the timing of complaints appropriate?
14. Should there be a “backstop” date (e.g. x months after the regulations take effect) by which “out of time” complaints must be made to a scheme?
15. How do you think this proposal will affect the numbers of additional disputes that would be considered by these schemes? What is the basis of this view?

Next Steps

40. We expect to make recommendations to Ministers on this matter shortly after submissions close on 9 April 2015. We would anticipate that any resulting regulations would commence in mid-2015.
41. A more general examination of the dispute resolution system for financial service providers, including scheme rules, will take place as part of the review of the FA Act and FSP Act. This review will commence in the first half of 2015. Further details on this review will be published on our website in due course.

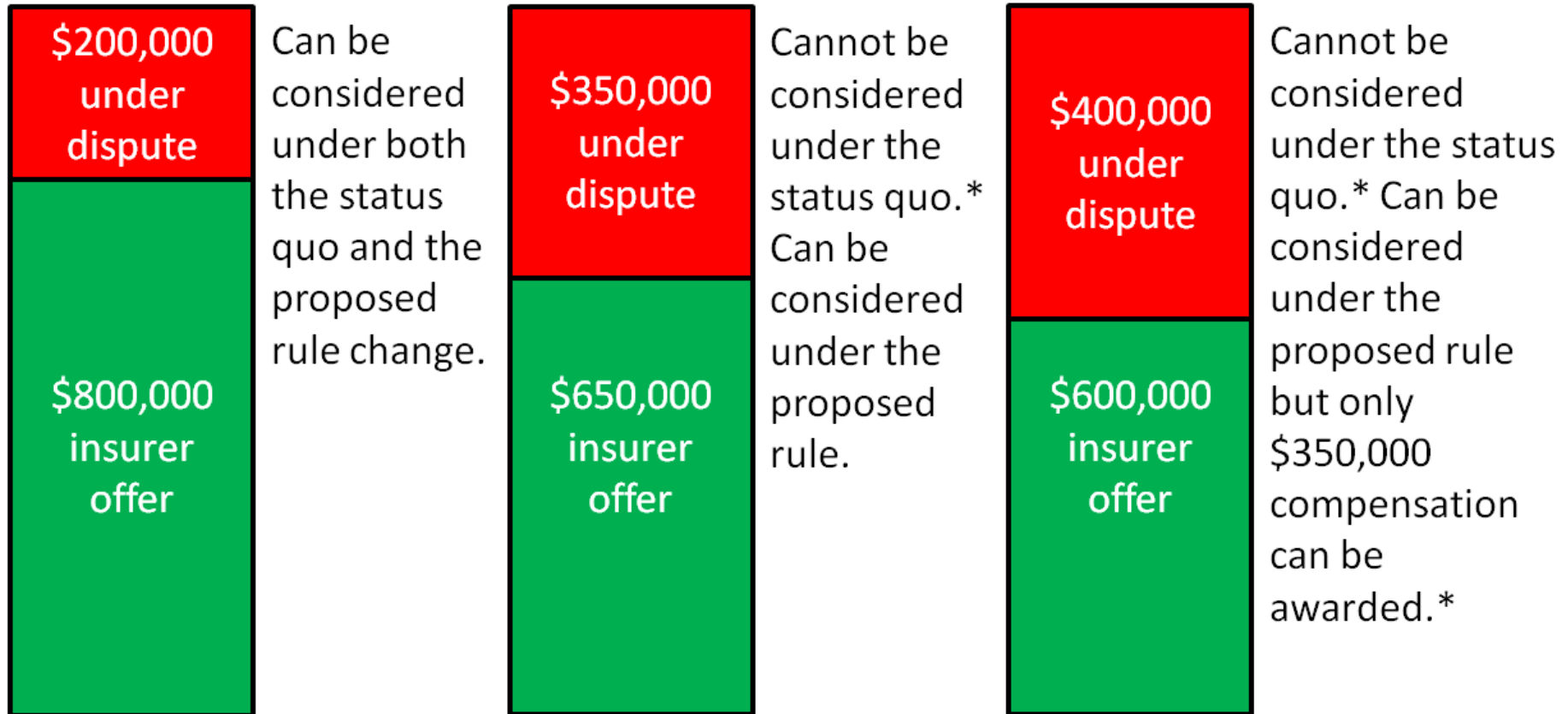
Annex 1

Schemes' limits on claim value or compensation

Scheme	
Banking Ombudsman	<p>25. The Banking Ombudsman will not consider a complaint if:</p> <p>25.1 The Banking Ombudsman concludes that:</p> <p>25.1.1 the amount the Complainant has claimed (or could reasonably claim) is more than the financial limit,</p> <p>25.1.2 the claim is part of a larger claim the Complainant has made (or could reasonably make), or is related to another claim the Complainant has made (or could reasonably make), and the total amount of the claims is more than the financial limit.</p> <p>26. If the Participant named in a complaint gives its consent, the Banking Ombudsman can make a recommendation or award on:</p> <p>26.1 a complaint where the amount being claimed is more than the financial limit,</p> <p>Financial limit: \$200,000 as at 1 July 2010</p>
Financial Services Complaints Limited	<p>8.1 FSCL cannot consider a complaint:</p> <p>(k) where the value of the Complainant's claim exceeds \$200,000.</p> <p>7.2 Notwithstanding any other paragraph of these Terms of Reference, FSCL may consider a complaint where all parties to the complaint and FSCL agree.</p>
Insurance and Savings Ombudsman	<p>5.2 The Scheme will only consider (or continue to consider) a Complaint made to the Scheme where the Scheme is satisfied that:</p> <p>a) the claim made in the Complaint either:</p> <p>i) represents a monetary amount not more than the Applicable Monetary Limit; or</p> <p>ii) is part of a larger claim (representing whatever monetary amount) that has been accepted by the Participant and that part represents a monetary amount not more than the Applicable Monetary Limit;</p> <p>"Applicable Monetary Limit" means:</p> <p>a) where the claim relates to a product that provides regular payments (as distinct from a lump sum): the sum of NZ\$1,000 (plus GST, if GST applies) per week; or</p> <p>b) in any other case: the sum of NZ\$200,000 (plus GST, if GST applies);</p> <p>5.3 Nothing in these Terms of Reference will prevent the Scheme from considering a Complaint, that is otherwise outside the Scheme's jurisdiction, if the Participant consents.</p>

<p>Financial Dispute Resolution</p>	<p>10. Compensation claimed must not be more than \$200,000</p> <ul style="list-style-type: none"> i. A complaint is not covered by the scheme if (subject to sub clause (2) the amount claimed as compensation: <ul style="list-style-type: none"> a. exceeds \$200,000; or b. would exceed \$200,000 if consolidated with the amount claimed in any other complaint or complaints brought by the same complainant that concern the same, or substantially the same, events or facts. ii. However, a complaint claiming more than that maximum amount is covered by the scheme if the complainant gives, on or shortly after making the complaint, a written waiver of any rights to the excess portion of the claim if the complaint is resolved under the scheme; iii. If the complainant waives any rights to the excess, then the relevant member is not liable for the excess amount if there is a binding resolution of the complaint under these rules; and iv. Compensation may be awarded up to an amount not exceeding \$3,000 for special inconvenience or expenses in making or pursuing the complaint. <p>13. Additional discretions relating to jurisdiction of the scheme</p> <ul style="list-style-type: none"> i. A scheme adjudicator may, at his or her discretion, accept a complaint for consideration under the scheme that is excluded from coverage by any of rules 8, 9, 10, and 11 if the relevant member and the complainant agree it should be considered under the scheme.
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Annex 2: Example jurisdiction where the homeowner claims total \$1 million rebuild or repair cost



*Unless insurer agrees otherwise