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By Email: fsrcsollicitor@royalcommission.gov.au

The Hon KM. Hayne AC QC
 Royal Commissioner

Dear Commissioner

Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry

We refer to our response to the Royal Commission dated 19 February 2018 and our supplementary response dated 5 March 2018.

AIA Australia (**AIAA**) has identified that one of its claims handling guidelines contained an explanation of a definition that was inconsistent with the policy definition, causing incorrect calculation of benefits in certain circumstances. We have assessed that this matter may have amounted to a breach of our obligation to provide financial services honestly, efficiently and fairly, did not meet community expectations, and did not reflect recent improvements made to our claims handling as noted in the *Internal claims handling review (2016)*, *Independent claims handling review (2016)*, and *Life Insurance Code of Practice (2017)* sections of our response dated 19 February 2018.

We have adopted an assessment of community expectations consistent with that set out in our 19 February 2018 response. A summary of this individual claim is set out in the table below, which is structured to capture our response to Questions 2 and 3 of the Royal Commission's letter dated 11 January 2018.

Incorrect calculation of pre-disablement income (2012 - 2017)

AIAA insures the members of a superannuation fund under several group life insurance policies (**Policies**). The Policies provide income protection (**IP**) benefits to be paid when the member is temporarily disabled. The amount of the IP benefit depends on the insured's member's pre-disablement income (**PDI**).

AIAA has calculated the PDI for some insured members who made an IP claim and who have been with the fund for more than twelve months but were employed for less than twelve months in a manner that was not consistent with the definition of PDI under the Policies. As a result, the affected members were not paid the correct amount of IP benefit based on the terms of the Policies.

In July 2017, a complaint was referred to the Superannuation Complaints Tribunal (**SCT**) in respect of the calculation of an insured member's PDI for the purposes of their IP claim.

AIAA investigated this complaint, and requested to resolve the matter directly with the relevant member. This was accepted by the SCT. In considering the complaint, AIAA noted that the member's PDI had not been calculated consistently with the definition of PDI under the relevant Policy. AIAA determined to recalculate the member's entitlement based on the correct definition under of PDI under the relevant Policy and to pay an additional amount to the member together with interest.

In early 2018 AIAA commenced an investigation into the cause for the error and found that the calculation of the PDI had been conducted in accordance with an internal claims guideline that AIAA

developed in 2013 to ensure that claims teams were applying a consistent approach to such calculations. Unfortunately, when developing the guideline, AIAA did not adequately consider whether the guideline was consistent with the terms of the Policies or whether its implementation required further agreement with the Trustee. This implied that any IP benefit calculations that were performed in accordance with the guideline could be inconsistent with the terms of the Policies.

The identification of the existence of an inconsistent approach to PDI calculations and the implementation of a PDI calculation guideline that was not in line with the terms of the Policies led AIAA to review all IP claims under the Policies involving a PDI calculation that were made since the inception of the Policies in 2004 to determine whether those claims were paid correctly. This review concluded in May 2018.

As a result of the review, AIAA identified that the issue adversely affected 305 claims and led to an expected underpayment of approximately \$3,933,333 (excluding interest).

To provide some context to these figures, AIAA currently insures over 1.5 million members under the affected Policies, and throughout the relevant period paid at least 17,500 IP claims. The PDI miscalculations affected a relatively small number of IP claimants (approximately 1.7%) and the amount of underpayment is also relatively small (about 0.25%), relative to the size of AIAA's overall expected obligations to members under the Policies.

AIAA notified ASIC and APRA about this matter on 11 May 2018.

Response to Royal Commissioner's Questions

3(a)	No. The original SCT complaint was withdrawn and settled as discussed above.	3(b)	No.
3(c)	No.	3(d)	Yes – inadequate internal controls during the period in which the incident occurred.
3(e)	<p><u>Remediation</u></p> <p>AIAA has committed to pay the trustee (on behalf of the affected insured members) any IP benefit underpayments arising from its application from this matter and to work with the trustee to return these funds to affected insured members. The payment will include interest in accordance with s57 of the <i>Insurance Contracts Act 1984</i> (Cth) and relevant regulations. AIAA expects the remediation to be completed by 30 September 2018 and AIAA continues to work with the trustee to progress the remediation actions as quickly as possible.</p> <p><u>Preventative steps</u></p> <ul style="list-style-type: none"> • A number of training sessions were and will continue to be conducted for relevant claims teams and their leaders and follow-up email communications sent to reinforce the correct PDI calculation process. • A number of peer and quality reviews were and will continue to be scheduled to ensure that the correct PDI calculation process is bedded down and that relevant claims teams are adhering to the process. • AIAA updated its claims guideline in March 2018 by removing the inconsistent section in relation to calculation of PDI. These steps together with the control improvements above help ensure that when AIAA receives an IP claim under the Policies that involves a PDI calculation in the future, the benefit will be calculated in accordance with the Policy definition of PDI. 		

- AIAA strengthened its controls for developing claims guidelines so that the author of such guidelines and any amendments were clearly documented. AIAA is implementing further controls so that any future claims guidelines will go through an internal due diligence process including product experts before their implementation to ensure that such guidelines are consistent with Policy terms. AIAA will also review other existing claims guidelines that deal with the Interpretation of Policy terms to ensure consistency with Policy terms. AIAA expects to progress the implementation of these further controls by 30 September 2018.

If you have any further questions or require additional information, please contact me at

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Yours sincerely



Damien Mu

CEO AIA Australia and New Zealand