

Late payment of insurance claims

HM Treasury

RPC rating: **fit for purpose**

Description of proposal

Businesses that suffer significant losses, for example through fire or flood, are likely to rely on insurance to repair any damages. Unreasonable delays in insurance payments can lead to further costs and loss of business. While Financial Conduct Authority rules require payments to be made promptly, at present businesses with more than 10 employees are not able to claim any compensation in the event of unreasonable delays leading to additional costs. The proposal will amend the existing legal position to introduce a legal liability for compensation in the event of unreasonable delays in payments leading to further loss.

Impacts of proposal

The proposal will apply to all businesses holding insurance policies. Individuals and smaller business, with 10 or fewer employees, are currently able to apply to the Financial Ombudsman Service for the award of compensation where loss can be proved. As this route will be less burdensome than seeking compensation under the proposal, these businesses are unlikely to receive additional benefit as a result of the proposal.

Based on evidence from the number of insurance claims, and significant consultation with the insurance industry and brokers, the department estimates that around 2% of the 20,000 business property insurance claims each year involve an unreasonable delay in payment and would be in scope of the proposal. Of these 400 cases, the department estimates that the proposal will result in insurance firms paying around 300 claims promptly in the future. The main benefit to business of prompt payment is the avoidance of 'coping costs' associated with arranging alternative finance, chasing debts etc. Evidence from business and insurance brokers suggests this will be worth between £2,000 and £5,000 per case, with a best estimate of an overall annual benefit to business of £1 million. If insurers continue to make all 400 payments late, the estimated coping costs would represent a robust lower bound for the level of compensation payments.

The department estimates that there will still be 100 claims each year where businesses do suffer from a late payment. These firms will benefit, in comparison to the baseline, from compensation payments for lost business should they take their case to court. However, there is considerable uncertainty relating to the likely level of benefit in each case (beyond coping costs) and the department has said that it is not possible to provide a robust estimate for the potential benefit. This assessment is reasonable.

Insurance companies are already under an obligation to pay promptly. Any compensation payments that are due as a result of unreasonable delays will be as a result of non-compliance with existing requirements, and as such would not affect the equivalent annual net cost to business (EANCB) for reporting purposes. Insurance companies will, however, incur costs as a result of:

- Investigating unmeritorious claims – based on consultation and experience from Scotland, the proposal is expected to result in around 15 additional investigations a year, costing insurers £0.4 million each year.
- Increased litigation as a result of legal uncertainty – insurers raised concerns during the consultation processes that following the change a number of additional legal cases will be brought in order to establish how the rule works in practice. Based on experience of previous changes this is expected to result in legal costs of on average £0.1 million each year for five years.
- Familiarisation – assessed as around £1,600 each for 125 insurers. The department has tested these estimates with industry, and expects them to result in a £0.2 million transitional cost.

The RPC is able to validate the department's estimated equivalent annual net cost to business (EANCB) of - £0.37 million.

Quality of submission

The IA is well drafted and clearly structured. The department has provided a clear narrative of how the proposal has been developed, and in particular how the extensive consultation has helped shape the final proposal. Any assumptions used are explained clearly, with concise summaries provided in the annexes.

The benefits to businesses that do experience unreasonable delays could be significant. While the individual nature of claims means it is not possible to provide a robust figure for this benefit, the department could improve the IA by providing an indication of the potential scale of these benefits.

While it does not affect the estimated impact of the proposal, the IA would have been improved by including a discussion of the costs and benefits of extending the existing Financial Ombudsman Service process to cover more situations or businesses. As the alternative process is assessed in the IA as being a more cost effective process for micro-businesses to pursue the IA would have benefitted from a discussion why changing eligibility for the FOS process would not have benefitted other businesses more than amending the legal route.

The IA states that the proposal is a recast of existing legislation with benefits for business, and should be scored as an OUT. The proposal could, however, be viewed as new regulation that is beneficial to business (a 'zero net cost' measure) in line with the current published version of the Better Regulation Framework Manual. The justification for viewing the proposal as a recast could be strengthened in the IA to clarify further this issue and

provide greater certainty, however the Committee also understands that the framework is being amended to remove the distinction between beneficial new regulation and recasts for scoring purposes and is, content to validate the proposal as beneficial to business with an EANCB of -£0.37 million.

Small and micro-business assessment

The IA sets out that businesses with 10 or fewer employees are already able to access compensation through the Financial Ombudsman Service so will be unaffected by the proposal. Other small businesses are likely to benefit from the proposal as it will reduce the prevalence and impact of late payments. If there are any small insurers affected by the proposal (through having to pay compensation for example) this will be as a result of their non-compliance with the existing requirements for payment.

Initial departmental assessment

Classification	OUT (recast)
Equivalent annual net cost to business (EANCB)	-£0.37 million
Business net present value	£4.54 million
Societal net present value	£4.54 million

RPC assessment

Classification	OUT (recast / beneficial regulation)
EANCB – RPC validated	-£0.37 million
Small and micro business assessment	Not required



Michael Gibbons CBE, Chairman