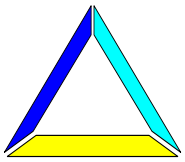
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Improving Dispute Resolution in Ukraine's Insurance Sector: Proposal for an Insurance Ombudsman

Executive Summary

Proper mechanisms for dispute resolution are important for the functioning of the insurance sector. In Ukraine, insurance litigation tends to be costly, troublesome and unfair. This is an impediment for the development of the sector.

To improve this situation we propose the establishment of an Insurance Ombudsman set up and financed by the insurance industry. He will be tasked to mediate and resolve disputes between policyholders and insurance companies in a flexible, objective and cost-efficient way. The Ombudsman institution has to be independent in structure and appearance. Therefore, it should be headed by a well-reputed expert and supervised by a neutral Council. In addition, the Ombudsman's verdicts should be binding for member insurance companies.

A well-functioning Ombudsman institution will bring about advantages for all market participants: Consumers will be better protected and benefit from higher standards. This is likely to increase the insurance industry's image considerably and act as a driving force for market growth. Increased credibility will allow participating insurance companies to acquire new customers. Finally, also the government will profit: The Ombudsman will help to decrease the case load of courts and relieve the supervisory authorities.

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1. The Importance of Adequate Dispute Resolution for the Insurance Sector

The functioning of a country's insurance sector depends largely on the quality and effectiveness of its dispute resolution mechanisms. Disputes between insurance companies and policyholders are common and unavoidable. If these disputes are not resolved in an efficient and fair way, this will create unnecessary costs and is likely to become a main obstacle for the development of a healthy insurance industry.

2. Characteristics of Adequate Dispute Resolution in the Insurance Sector

As disputes in business relations inevitably occur, they should be settled in a proper way. A good settlement mechanism has to fulfil three fundamental criteria: cost-efficiency, fairness and accessibility.

First, the settlement of disputes should be *cost-efficient and time saving*. Institutions and procedures of dispute resolution should consume as few economic resources as possible. Efficiency also means minimized delays in reaching resolution. Speedy settlements are crucial to minimize follow-up costs of arising disputes.

Second, dispute settlement should be *impartial and fair*. The parties of the dispute must perceive themselves to be treated equitably and objectively. They should be properly involved and satisfied with the process of settlement. This implies a high level of transparency about how decisions are made. Every decision should be retraceable and well-grounded. To foster fairness the system should also be structured to balance power inequities between the parties.

Third, the dispute resolution scheme has to *be easily accessible and well-known*. In most countries cost is the largest barrier to formal dispute resolution. On top, the prevailing inefficiency due to delays or excessive complexity can discourage their use. Appropriate accessibility means that the parties know about the system and are be able to make use of it to defend their position without too many expenses and effort.

3. Dispute Resolution in Ukraine’s Insurance Sector at Present

Measured by the above criteria, the mechanisms of dispute resolution in Ukraine’s insurance market leave much to be desired. The court system is supposed to resolve all insurance disputes. Courts at present however do not fulfil the premises of a good system of dispute resolution.

First of all, the existing court system is inefficient. The judiciary lacks sufficient staff and funds. Simultaneously, there is a rapidly growing case load of disputes. Court cases therefore take considerable time and effort. The delays commonly result in high legal costs and dissatisfaction of the parties involved. State judges have limited experience in insurance litigation and lack of necessary skills to resolve insurance disputes efficiently and objectively.

Second, the court system is neither fair nor transparent. In the ambit of insurance, policyholders are mostly unaware of their rights and often unable to enforce them. It is difficult to predict and understand how decisions are made. There is no guarantee that the court will rule in favour of the party with the strongest legal position. Instead the adversary party with more resources and influence is likely to have strong advantages. Public confidence in the legal system remains generally low. Despite a decade of modernisation and successful reform, Ukrainian courts have yet to prove themselves as independent and

powerful bodies. There is a strong belief among businessmen and the general public that bribery is widespread and indispensable for winning a case.

Third, access to justice is not satisfactory. Due to high costs, inefficiency and the systematic unfairness potential claimants are discouraged to make use of the judicial system. Many citizens and policyholders cannot even afford to pay the registration and representation fees necessary to enter the formal legal system. The effort and cost involved in a legal procedure are very high. Most insurance customers are reluctant to take court action to enforce their rights as outcomes are uncertain and risk is high. Likewise most businessmen would rather settle their insurance disputes using non-legal remedies.

4. Proposal for Improving the Current Situation: An Insurance Ombudsman

As the quality of dispute resolution is important for the functioning of the insurance sector, it is necessary to seek for ways to improve the current situation.[1] It is mandatory to further improve the transparency and effectiveness of civil litigation. Ongoing reform of the legal system will be indispensable. Litigation, the traditional manner of dispute settlement, may however not be the first choice in resolving insurance disputes in Ukraine. Especially on the short run the court system is unlikely to provide for efficient settlement. Alternative, complementary methods outside the judicial system may instead be more satisfactory.

We propose the formation of an alternative dispute resolution scheme for the insurance sector in Ukraine: An Insurance Ombudsman. The main task of an Insurance Ombudsman is to resolve conflicts between insurance companies and their customers. Before going to court a complainant can first address the Insurance Ombudsman for dispute resolution. The institution functions as the last resort for the informal resolution of complaints. Before accessing the Insurance Ombudsman consumers must attempt to resolve their complaints directly with their insurer. If the dispute cannot be solved in a consensual manner, the Insurance Ombudsman will act as third-party arbiter. The Ombudsman will then examine the facts of each complaint and give his recommendation and judgement in the case, according to applicable law and good insurance practice. It is important to emphasize that in all Insurance Ombudsman schemes policyholders retain their right to seek redress in the regular court system and are free to cancel their complaint at any time. By accessing the Ombudsman's service they don't prejudice their legal rights.

The Ombudsman institution is a useful complement to the court system rather than a substitute. It is put in place primarily for individual consumers.[2] Moreover the Insurance Ombudsman typically deals only with relatively small cases up to a limited amount in dispute.[3] Insurance Ombudsman institutions are normally headed by an individual Ombudsman. The Ombudsman as a person plays a crucial role. He stands for the entire organisation and has to approve all resolutions reached within his organization. He is assisted by a team of qualified legal professionals specialised on insurance cases.

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[1] For further recommendations for the development of the Insurance Sector in Ukraine see Policy Paper T 21 by the German Advisory Group in Ukraine and the Institute for Economic Research and Policy Consulting: "The Importance of the Insurance Sector for the Economic Development in Ukraine: Analysis and Policy Recommendations". Available at: http://www.ier.kiev.ua/English/papers/t21_en.pdf.

[2] Large companies holding insurance policies are denied access to the Ombudsman's services in most counties.

[3] The German Ombudsman institution for instance only accepts cases up to an amount in dispute of 50.000 EUR.

Box 1: Overview of Ombudsmen Institutions

Ombudsman is a Swedish word, meaning a representative or agent of the people. Ombudsmen provide the citizen with an alternative to court for resolving disputes. There are many different types of Ombudsmen. Some deal with complaints about public sector organisations, others arbitrate in private sector businesses. The classical Ombudsman is an independent officer for the citizens who supervises the public administration and deals with complaints against administrative injustice and maladministration. Ombudsmen such as the Parliamentary Ombudsman or the Human Rights Ombudsman have become a global phenomenon, estimated to be operative in something like 90 countries. The 1980s and 1990s have seen a rapid development of Ombudsmen as a consumer redress mechanism in the private sector, so that they now cover such diverse areas as financial services, estate agents or legal services. The first binding Insurance Ombudsman was established in the United Kingdom in 1981. The scheme has since then spread worldwide.

Insurance Ombudsman institutions can either be set up through a private initiative or otherwise by the government. In most countries the Insurance Ombudsman has been established by the insurance industry - as a means of beneficial self regulation. It is typically a non-governmental organisation under private law founded and financed by a group of insurance companies. In some countries however the Insurance Ombudsman has instead been established by the state. The institution can be given statutory status through a legal act such as a parliamentary law or a decree. (e.g. Poland or India, see Table 1). In either case governmental support is essential for the successful performance of the Ombudsman scheme.

Another central question is whether or not the Ombudsman's decisions are binding for the insurers and up to which amount. In countries like Poland or Switzerland the Ombudsman Institution cannot make binding decisions and has a purely mediating role (see Table 1). In such a scheme the Ombudsman submits neutral proposals without binding character. The adversary parties are free to accept or to refuse these proposals. Oppositely in Germany, the United Kingdom or Ireland, where the Insurance Ombudsman has been very succesfull, the Ombudsman's decisions have a binding character. The rulings are binding for the insurers up to a certain amount in dispute, while the complaining policyholder can reject the verdict (see Table 1). Insurers that have become member of the private Ombudsman scheme in these countries agree to accept the Ombudsman's terms of reference. In so doing, they bind themselves voluntarily to the ruling of the arbitrating Insurance Ombudsman. By taking decisions which are disadvantageous for the insurer, the Ombudsman directly affects the financial situation of the company in a negative way.[4] At first sight this seems paradox: Why should an industry create an institution that empowers their customer and might painfully affect the profitability of their companies? The reason is that ultimately an Insurance Ombudsman is likely to be very advantageous for the insurance industry (see Part 5 for a comprehensive explanation).

Independence and impartiality of the Insurance Ombudsman are of utmost importance to unfold the positive features of the scheme. To be credible and effective, it is imperative that the Insurance Ombudsman scheme is independent in its structure, function, and appearance. If the Ombudsman's independence is safeguarded he can act in an impartial manner and fulfil his duties appropriately. If he it is not his public appearance will be bad and the scheme is

[4] In Germany, 37.7% of the Ombudsman's rulings from October 2001 to March 2004 were to the disfavor of insurance companies.

likely to become a farce and a waste of money. Independence means that the Ombudsman is free from interference or retaliatory penalties such as removal or the reduction of its budget. Of course the Ombudsman has to be controlled. To ensure an adequate system of checks and balances the Ombudsman is typically supervised by a Board of Directors and/or a neutral Council.

Table 1: Insurance Ombudsman Institutions in Selected Countries

Country	Private/Statutory*	Year of Establishment	Binding/Non-binding for insurers**
Canada	Private	n.a.	Non-Binding
Finland	Private	1971	Non-Binding
Germany	Private	2001	Binding for cases up to EUR 5.000
India	Statutory	1998	Non-Binding
Ireland	Private	1992	Binding for cases up to EUR 160.000
New Zealand	Private	1995	Binding for cases up to EUR 54.000 ***
Poland	Statutory	1995	Non-Binding
Singapore	Private	n.a.	Binding for cases up to EUR 50.000 ***
South Africa	Private	1985	Binding without limit
Switzerland	Private	1972	Non-Binding
United Kingdom	Until 2001: Private Since 2001: Statutory	1981	Binding for cases up to EUR 150.000 ***

* Indicates whether the Insurance Ombudsman scheme has been given statutory status through a legal act by the government or if it is a private organization set up by the insurance industry.
** Indicates whether the Ombudsman's decisions are binding for insurance companies or not and up to which sum in dispute a case will be processed. In all countries policyholders can reject the Ombudsman's verdict.
*** Approximate value in EUR using current exchange rates (case limits in local currency: GBP 100.000 in the United Kingdom; NZD 100.000 in New Zealand and SGD 100.000 in Singapore).

5. Benefits of an Insurance Ombudsman for Ukraine

The Insurance Ombudsman can be an excellent instrument for the settlement of insurance disputes. International experience has shown that an Insurance Ombudsman is capable to meet the aforementioned criteria of adequate dispute resolution better than the formal court system.

Key Advantages: Time and Cost Efficiency, Expertise and Accessibility

The Insurance Ombudsman offers *good value for money* for the resolution of insurance disputes. In Germany a settlement through the Insurance Ombudsman is known to be several times cheaper than a legal process. The Ombudsman agency will need far less resources then courts. Also the immediate expenses by the disputing parties are reduced considerably because, unlike the courts, legal representation is neither required nor advantageous.

The Ombudsman can resolve conflicts in an informal way. He is far *more flexible* than formal court proceedings allow for. Although he must act fairly, he is not constrained by rules of evidence and rigid procedures such as formal hearings or face-to-face cross-examinations. As a result the settlement process by an Ombudsman is usually much *quicker* than a court case.

The Ombudsman's *expertise* is another crucial advantage as most judges in the court system lack of sufficient knowledge about actual insurance practice. The appointed Insurance Ombudsman will be someone with excellent knowledge of the insurance business and law. Judgments approved by a reputed expert are likely to be more objective and trustworthy.

Finally an Insurance Ombudsman is commonly more *easily accessible and user-friendly* then courts. Market participants will be encouraged to access the Ombudsman institution as costs and risks are lower and outcomes are likely to be fairer. Its better accessibility is also intellectual. In order to access the service no special expertise or professional help is needed. The Ombudsman will ideally give clear, jargon-free reasons for his decisions - so that any fair-minded person can understand how he reached a particular conclusion.

Benefits for all Parties: Insurance Companies, Customers and the State

Bearing the key advantages in mind the introduction of a properly designed and well functioning Insurance Ombudsman will bring considerable direct and indirect benefits for insurers and their customers. Also the government will ultimately profit from such an institution.

The creation of an Insurance Ombudsman will be highly *advantageous for insurance consumers*. They will enjoy increased access to justice with faster and cheaper settlement of their complaints. The market position of policyholders will be strengthened considerably as they are enabled to enforce their legitimate rights more easily and without too much risk. A complainant who refers a dispute to the Ombudsman does not prejudice his or her legal rights and can reject the Ombudsman's decision. Moreover the Insurance Ombudsman will help to improve standards in the insurance industry. By investigating individual cases, the Ombudsman may highlight more generalised weaknesses in practices, rules and attitudes in the insurance market. Complaints submitted to the Ombudsman turn into catalysts for change and improvement. The Ombudsman can share his knowledge and experience with the outside world - to help consumers and firms settle disputes without the need for his involvement. Companies are e.g. encouraged to design efficient consumer complaint systems to avoid Ombudsman proceedings and sanctions. The Insurance Ombudsman institution may help to identify the "bad apples" that continue to deny valid claims. He can seek out systemic causes of injustice in a way courts and tribunals are ill-equipped to do. Thus, an Ombudsman is not only an instrument of redress, but also has the function of quality control.

The insurance industry will benefit substantially from setting up and financing an Insurance Ombudsman. Arising disputes will be settled faster and cheaper by avoiding the highly inefficient court system. Companies will be less troubled by awkward and time consuming trials and can better focus on their core business. The existence of a proper scheme of dispute resolution and consumer protection will be for the industry's own good. An independent and well reputed Insurance Ombudsman will contribute to building up public confidence in the insurance industry. Higher standards and guaranteed legal rights will improve the industry's image and facilitate the acquisition of new customers. Insurers that participate in the Ombudsman scheme are likely to conquer new groups of consumers and expand their

business considerably. This positive effect will easily make up for the costs and effort related to the Ombudsman institution - particularly on the long run.

Finally, the *state will profit* in various ways from an Insurance Ombudsman institution. First of all the case load of courts will be reduced as most insurance cases are settled before they come to trial. The industry's self regulation of dispute settlement will furthermore disencumber the insurance supervision. Raising standards and fairer treatment of policyholders will reduce the need for interventions and admonitions. Many complaints previously processed by the supervisory authorities can be directed to the Insurance Ombudsman instead. By defending weaker market participants the Insurance Ombudsman will even fulfil a function of social protection: Denial of legitimate claims (e.g. of life or disability insurance) can seriously affect the financial situation of policyholders who might then be constrained to seek public relief. If such improper claims practices are restricted and opposable it will alleviate the pressure on social welfare systems.

6. Detailed Recommendations for an Insurance Ombudsman in Ukraine

Proposal 1: Establish a *Private* Insurance Ombudsman

In our view, the Insurance Ombudsman in Ukraine should be set up by the insurance industry, not by the government. Thus, we recommend the creation of a private Ombudsman.[5] The driving force for the creation of an Ombudsman should be a group of insurance companies, interested in sustainable market development and high quality standards. The group of founding members does not necessarily need to cover the lion's share of the insurance market. It is rather quite possible that a relatively small number of wise and candid insurers take the initiative to ameliorate their image and acquire new customers, as happened in the United Kingdom in 1981.[6] Experience has shown that there is a steady increase in the number of participating insurance companies, once the Ombudsman is established and popular. Many insurance companies appreciate the considerable benefits of an Insurance Ombudsman only after he has become operational. Moreover, non-members are likely to perceive rising pressure on the part of actual and potential customers to join the Ombudsman scheme.

Proposal 2: Funding through Member Insurance Companies

In accordance to encouraging international experience the Ombudsman institution should be primarily financed by participating insurance companies. We recommend raising funds in relation to the annual market share of member insurers, as is the case in Germany. This will ensure a solid financial basis. In addition, the scheme should receive money from insurers on a cost per case basis as practiced in Singapore or South Africa. Member insurance companies that are subject to complaints will have to pay a specified amount for each case that is processed by the Ombudsman. This will set the right incentives, as it punishes companies with wrongful claims practices and improper complaint handling structures.

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[5] However, the private initiative needs to be appropriately accompanied by the state. The government is to provide for an appropriate legal environment for the Insurance Ombudsman. Moreover, it will be important that politicians and the financial supervisory authorities back the Ombudsman institution and encourage insurance companies to join the scheme.

6 The Insurance Ombudsman Bureau in the United Kingdom was established in 1981 thanks to the founding initiative of only 3 large insurance companies. In Germany, the Insurance Association GDV has been the main promoter of the Insurance Ombudsman.

Proposal 3: *Binding* Verdicts for Insurance Companies

The Ombudsman should have enough powers to be effective. Therefore, the Ombudsman's verdicts should be *binding for the insurance companies* up to an amount in dispute which covers the majority of disputed cases. This will secure the Ombudsman's autonomy and will contribute to improve his image among policyholders. If an insurance company denies accepting a ruling, the Ombudsman should have the power to publish the fact of such failure or even terminate the membership.

Proposal 4: Erect a Structure of Checks and Balances

To make sure that the Ombudsman is independent from the insurers which finance him and to establish a system of checks and balances, we suggest erecting a structure involving the following three organs: *Board, Council and the Ombudsman Bureau* itself. This model has proven of value in many countries with a private Insurance Ombudsman such as in Germany or New Zealand. The powers of the Board of directors, elected by the member insurance companies, should be limited. The Council as a separate independent body should instead play a key role. It should consist of public interest and consumer representatives but can include insurer's nominees as well.[7] Conflict resolution systems should be designed with, not for, those who use or are affected by them. It is therefore advisable to appropriately incorporate representatives of all relevant stakeholders.

Proposal 5: Service Free of Charge and Restricted to Cases up to EUR 10.000

To encourage the use of the Insurance Ombudsman mechanism, services should be *free of charge* for complainants at least in the first period of its existence. Once the Ombudsman is well established, it should however be considered to introduce administrative fees.

We recommend to enable individuals and business entities alike to access the Ombudsman's resolution services. There should however be an *upper limit*. The Ombudsman should only accept and process cases up to a certain amount in dispute. Such an upper limit should be high enough to comprise the large majority of consumer disputes. It could e.g. be set at EUR 10.000[8]. The ceiling will help to exclude large and well-equipped corporations to make use of the Insurance Ombudsman, while it will not prejudice the mass of individual policyholders.

Proposal 6: Choose a Well-Reputed Candidate

It is important that the Ombudsman gains public reputation and acceptance as soon as possible. In Ukraine public mistrust and bad experiences with institutions make the concept of independence a particularly difficult one to disseminate. Hence the selection of an appropriate candidate plays a crucial role. The Ombudsman has to be regarded as an impeccable, unbiased and powerful arbitrator. He should be preferably a person of recognized knowledge, objectivity, and integrity.[9]

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[7] In a meeting held with the German Insurance Ombudsman Prof. Römer, he emphasized the positive role and performance of the Council for the design and improvement of the German Ombudsman scheme. It consists of 27 representatives of insurers, consumer organizations, insurance supervision and political parties represented in parliament.

[8] In Germany, the upper limit at present is EUR 50.000.

[9] In Germany the incumbent advocate is a former judge of the highest Civil Court, a well-reputed specialist in insurance law. His standing has contributed largely to the success of the German Insurance Ombudsman scheme.

Final Recommendation: Keep the Scheme Open to Change

It is not possible to foresee all eventualities and the reaction of the public and insurance companies to a specific Ombudsman scheme. Many problems and weaknesses of the concrete institution will only become apparent in the course of time. It is thus essential that the Insurance Ombudsman institution allows for necessary changes in the future. The scheme has to be kept opened to change and improvement.

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