

The Committee Secretary
House Standing Committee on Economics
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Parliament House
CANBERRA ACT 2600
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19 January 2012

Dear Sir/Madam

REVIEW OF THE INSURANCE CONTRACTS AMENDMENT BILL 2011

The Insurance Council of Australia¹ (Insurance Council) welcomes the opportunity to provide comment to the House Standing Committee on Economics in relation to the Insurance Contracts Amendment Bill 2011 (the IC Bill). We appreciate the additional time allowed for finalisation of this submission.

Submissions on the IC Bill were requested by 13 January 2012. However, the IC Bill is essentially enabling legislation, with the detail of the standard definition of flood and the Key Facts Sheet to be contained in regulation. Consultation is currently taking place on the draft regulations for the standard definition of flood, with submissions due 3 February 2012. We understand that consultation on the draft regulations for the KFS will take place several months into 2012. There is also the related consultation on the proposal that all insurers must offer flood cover as part of home building and home contents insurance policies, while giving consumers the opportunity to 'opt-out' of that cover. Submissions on this latter proposal are due 30 March 2012.

The Insurance Council's concern is that the IC Bill and related regulations need to be looked at together carefully in order to analyse effectively their overall impact. While the subject of careful consideration, our comments therefore in this submission are preliminary and may be revisited as we review related pieces of draft regulation.

Insurance Council members have a number of concerns with the IC Bill:

- As the Bill is currently drafted, insurers would be required to clearly inform the insured in writing whether flood cover is provided when a new policy is provided or a policy is

¹ The Insurance Council of Australia is the representative body of the general insurance industry in Australia. Our members represent more than 90 percent of total premium income written by private sector general insurers. Insurance Council members, both insurers and reinsurers, are a significant part of the financial services system. June 2011 Australian Prudential Regulation Authority statistics show that the private sector insurance industry generates gross written premium of \$34.3 billion per annum and has total assets of \$114.9 billion. The industry employs approx 60,000 people and on average pays out about \$95 million in claims each working day.

Insurance Council members provide insurance products ranging from those usually purchased by individuals (such as home and contents insurance, travel insurance, motor vehicle insurance) to those purchased by small businesses and larger organisations (such as product and public liability insurance, professional indemnity insurance, commercial property, and directors and officers insurance).

renewed, varied, extended or reinstated. Such a level of disclosure is excessive and unnecessary;

- Without questioning the use of a standard definition of flood, it is not clear from the wording of section 37D whether commonly used limitations on flood cover are to be allowed;
- It is unclear what exactly will be the restrictions on how the insurer must inform the insured whether the contract provides flood cover;
- The Bill limits the application of existing provisions in the *Insurance Contracts Act 1984* (Cth) (the IC Act) which would provide flexibility in the provision of the Key Facts Sheet (KFS) to customers;
- Inconsistency will be created in the methods of communicating with policyholders. After passage of the Bill, electronic communication will be unambiguously possible for KFS but not other notices required under the IC Act; and
- Although a transition period of 2 years is proposed, in practice this will actually be less than 12 months. Although general insurers will move to revise their PDS/policy documents as soon as possible, it is unreasonable to require that this be finalised within 12 months.

These issues are further detailed in the Attachment.

If you require any further information, please contact the Insurance Council's General Manager Policy – Regulation, Mr John Anning on (02) 9253 5121 or janning@insurancecouncil.com.au.

Yours sincerely



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Section 37C Insurer must clearly inform insured whether prescribed contract provides insurance cover in respect of flood

The Explanatory Memorandum states “the purpose of introducing a standard definition is to reduce consumer confusion regarding what is and what is not included in flood coverage”² and that “it will also improve consumer’s ability to evaluate potential insurance policies and compare between different insurers”³. From these statements, it appears the overall goal is to empower the consumer at the point in time when the consumer makes a decision to initially purchase an insurance policy.

This is an appropriate focus for these reforms. We submit that there is little benefit in continually reminding an insured that their policy provides or does not provide cover for loss or damage caused by flood where no change to the flood coverage has occurred.

The Insurance Council therefore has concerns with the application of the proposed section 37C in the IC Bill, which states:

37C Insurer must clearly inform insured whether prescribed contract provides insurance cover in respect of flood

Before entering into a prescribed contract, the insurer must clearly inform the insured in writing whether the contract provides insurance cover in respect of loss or damage caused by, or resulting from, flood as defined by the regulations.

By virtue of section 11(9) of the IC Act, the requirement imposed by the proposed section 37C would apply not only to new policies but also to renewals, extensions, variations and reinstatements of the contract of insurance.

(9) Subject to subsection (10), a reference in this Act to the entering into of a contract of insurance includes a reference to:

(a) in the case of a contract of life insurance--the making of an agreement by the parties to the contract to extend or vary the contract;

(b) in the case of any other contract of insurance--the making of an agreement by the parties to the contract to renew, extend or vary the contract; or

(c) the reinstatement of any previous contract of insurance.

It is unnecessarily onerous to require a general insurer to inform the insured in writing in all these circumstances. For example, an individual may take out a home contents insurance policy and would be informed, in writing, whether the contract provides insurance cover in respect of loss or damage caused by/resulting from flood. If the insured then contacts their insurer the next day to vary the contract by adding an additional item to the policy, under the proposed section 37C the insurer would be required to again inform the insured, in writing, whether the contract provides insurance cover in respect of loss or damage caused by/resulting from flood.

² Insurance Contracts Amendment Bill 2011 Explanatory Memorandum, p7

³ Insurance Contracts Amendment Bill 2011 Explanatory Memorandum, p7

The Natural Disaster Insurance Review noted that between 5-10% of dwellings in Australia are subject to risk of flood⁴. On this basis, it is arguable whether it is necessary to single out flood cover for particular disclosure beyond the obligations of sections 35 and 37 of the IC Act. However, even accepting this need, it is difficult to understand why at least 90% of policyholders for whom flood is not a significant risk need to be informed of the extent of flood cover not only prior to the initial purchase of the policy but also prior to any renewal, extension, re-instatement or variation. One must bear in mind that a policy of insurance contains a whole myriad of cover and the most relevant risks for one customer may not be the same for another.

The cost of complying with such an extensive notification requirement will be particularly high, given that section 33D contains a blanket prohibition on the provision of a KFS as a means of satisfying an obligation to clearly inform.

This issue can be overcome with an amendment so that the words "before entering into a prescribed contact" in section 37C are dealt with in a similar way to the current sections 35 and 37 under subsection 11(10) of the IC Act. That is, the insurer should only be required to clearly inform the insured whether the prescribed contract provides insurance cover in respect to flood (as defined by the Regulations):

- at or before initially entering into a contract;
- at or before the first renewal, variation, extension or reinstatement of the contract after the amending legislation commences, and
- at or before any renewal or variation but only where the renewal or variation changes the extent of flood cover.

The extent of restrictions on how the insurer informs the insured about flood cover

Proposed section 37C of the Bill presently states "the insurer must clearly inform the insured in writing whether the contract provides insurance cover in respect of loss or damage caused by, or resulting from, flood as defined by the Regulations". It is unclear what exactly will be the restrictions on how the insurer must inform the insured. The only known prohibition is that under proposed section 33D the provision of a KFS does not constitute clearly informing. The Explanatory Memorandum provides no further information.

It is essential that flexibility in the method of notification be allowed. Presently in sections 35 and 37 of the Act the requirement to clearly inform in writing is clarified by stating "whether by providing the insured with a document containing the provisions, or relevant provisions, of the proposed contract or otherwise". It would create better consistency and certainty if the proposed section 37C adopted similar wording to sections 35 and 37 of the Act.

Need for clarity on ability to exclude flood cover

Insurance policies providing flood cover commonly include:

- an exclusion for flood damage which occurs within the first 72 hours of a policy first being issued;
- exclusions for specific items of high risk property such as sea walls, jetties and pontoons; and

⁴ Natural Disaster Insurance Review Inquiry into Flood Insurance and Related Matters, September 2011, p2

- general exclusions that apply to all types of loss under the property such as where the home does not comply with building laws and regulations or a flood that was the result of malicious or deliberate damage to a dam.

Insurance Council members are concerned that section 37D as currently worded would operate to prohibit any limitation on the operation of the standard definition of flood. Such a result would be clearly unreasonable and we would appreciate consideration being given to how the wording of this section could be clarified.

The need for flexibility in the provision of the Key Facts Sheet

The IC Bill states the circumstances and manner in which the insurer must provide a KFS will be outlined in the Regulations, which are yet to be issued. It is extremely difficult to provide considered comment on the provision of a KFS without this information.

We note the proposed section 33C(4) of the IC Bill states section 11(11) and section 69 of the IC Act will not apply to the provision of KFS. We do not support this position. The Explanatory Memorandum notes that flexibility is required in certain situations⁵ yet removes the existing provisions in the IC Act which provide this flexibility. It would be desirable to maintain consistency across the legislation by allowing insurers to utilise these provisions in relation to the KFS.

The Insurance Council therefore recommends that proposed subsection 33C(4) in the IC Bill be removed. However, if there are considerations which make this unacceptable to the Government, it is critical that the Regulations are drafted to provide sufficient flexibility.

The Explanatory Memorandum states, in relation to KFSs, that “the regulations will provide some flexibility in the timing of their provision”⁶. Such flexibility is necessary as there will be circumstances where the customer requires a policy immediately and it will not be possible to provide a KFS before the policy is entered into, for example where a customer has just purchased a home or entered into a rental agreement and is seeking cover.

It would be highly undesirable to create a situation where a customer was exposed with no insurance cover because an insurer could not provide cover (without committing an offence) as it was not practicable to provide a KFS to the customer. Therefore, provisions similar to section 11(11) and section 69 be included in the Regulations. If there is concern a customer will be “locked into” a policy before they have a chance to review the KFS then this is unwarranted because there is a cooling off period for home and contents policies under the Corporations Act. In this period (minimum of 14 days) the customer can choose to not continue with the cover.

Electronic communication should be allowed for all information required under the IC Act

We note that proposed subsection 33C(2) allows for regulations to be made to prescribe circumstances in which a KFS may or must be provided by electronic means. The Insurance Council and its members have consistently argued that the Government should reform the IC Act to enable general insurers to use electronic means to communicate with consumers.

⁵ Insurance Contracts Amendment Bill 2011 Explanatory Memorandum, p17

⁶ Insurance Contracts Amendment Bill 2011 Explanatory Memorandum, p17

The speed of change in how consumers expect to be able to communicate with their service providers makes these changes imperative.

From a practical perspective, general insurers need consistency in the methods for the delivery of notices under the IC Act and delivery of documents under the Corporations Act. The IC Bill and proposed regulations would mean that electronic communication could be used with certainty for KFSs and documents required under the Corporations Act but not for other notices required by the IC Act.

Insurers are keen to communicate with consumers through electronic means. It is burdensome to require insurers to maintain two methods of communicating with the same customer, even though the customers may prefer only being dealt with electronically.

The Insurance Council therefore strongly supports the use of electronic communication to provide a KFS to consumers as a first step but urges the Government to go further with this reform and make the necessary amendments to clarify that all notices required under the IC Act can be provided electronically if the customer agrees.

Timeframe for implementation

The Explanatory Memorandum to the IC Bill specifically notes that the Regulations in relation to the measures in the Bill, that is, the standard definition of flood and the Key Facts Sheet, will take effect 2 years after the date the Regulations are made. However, this does not mean the general insurance industry has a 2 year transition period within which to make the necessary changes.

Any new policy that is entered into or renewed at least 12 months after the date the Regulations are made will still be in force at the date that the standard definition of flood is deemed to apply. Unless the content of the PDS contains the standard definition of flood at the time of the new business or renewal, at the end of the transition period the standard definition of flood will apply rather than the definition in the PDS.

This will mean that for new business, all PDSs must contain the standard definition of flood at or before 12 months before the end of the transition period or they will be out of date and misleading at the date the standard definition of flood is deemed to apply. Furthermore, as renewal invitations are generally sent 6 weeks before the expiration of the insured's period of insurance, for renewals PDSs will need to contain the standard definition at least 6 weeks before the new business PDSs.

In effect, this means insurers have less than 12 months to make the necessary changes to PDSs. The Insurance Council believes this is an unreasonable burden to place on the general insurance industry. Several Insurance Council members have many PDS/policy documents and to review them thoroughly and reissue them within 12 months would be a heavy imposition. The Bill and the proposed regulations will require significant changes to both systems and documents and insurers will require a reasonable period of time to make such changes. We strongly encourage the Government to consult further with the general insurance industry to determine a reasonable timeline for implementation.

It will also be essential to consider how the need to comply with changes flowing from passage of the IC Bill will interact with the consequences of other regulatory changes such as the Future of Financial Advice legislation and other amendments to the IC Act expected to

be introduced into Parliament in the first half of this year. An overall transition period should be agreed that would allow PDS/policy documents to be revised once rather than subject to continual change.

Drafting issue

The use of the term “prescribed contract” within Division 1A is confusing given that it is commonly known in relation to its usage in Part V Division 1. It may be possible to use an alternative term such as “nominated contract”.