

The Hon. Bill Shorten MP
Assistant Treasurer and
Minister for Financial Services and Superannuation
PO Box 6022
PARLIAMENT HOUSE ACT 2600

1 February 2012

Dear Minister

Consultation Feedback on Regulations Supporting a Standard Definition for Flood

The Insurance Council of Australia Limited (ICA) welcomes this opportunity to provide input to the consideration of regulations supporting the introduction of a standard definition for flood in some insurance contracts.

The ICA refers to its submission on the Insurance Contracts Amendment Bill 2011 (IC Bill) and again raises concerns in relation to the IC Bill, the Regulations and the Consultation Paper being looked at separately with separate submission dates. It is important that solutions to achieve a more sustainable approach to flood insurance are addressed in a coordinated process.

Regulations 9 and 13 and a definition of “Prescribed Contract”

The trigger for the application of the Insurance Contracts Act (the Act) provisions, regarding a standard definition for flood, are Regulation 9 in respect to domestic buildings and Regulation 13 in respect to Contents.

The ICA submits that the Australian market currently provides some specialty residential products that meet the definitions under these regulations, but are not relevant to the standard flood definition as these specialty covers do not provide inundation related cover. Regulatory changes that prevent the delivery of these specialty products will have an unintended community impact.

Examples of these specialty products include policies that only provide theft and malicious damage cover to a home building. A policy such as this meets the description of.....**providing insurance cover (whether cover is limited or restricted in any way) in respect to the destruction or damage to a home building.....**and would be caught by the proposed regulation requiring flood cover to be offered.

These specialty products fill a niche requirement in the community for those seeking only limited cover. Under the current proposal these products would become unviable. Those seeking limited cover would be forced to be uninsured or to purchase cover they do not wish to have.

The ICA recommends that consideration be given to:

1. The regulations being amended to not apply to policies defined under Regulation 9 and 13 where the policy does not provide water related or storm perils cover.
2. Creation of a mechanism where an insurer can apply to ASIC for a product exemption regarding use of the standard flood definition.

Further in Regulation 29(C)(c) it should be made clear that (c) is meant to be a combination of a) and b). This is not clear from the drafting.

Regulation 29A Definitions for Division 8

A 'strata title residence' is defined to mean a residence to which the following applies:

- (a) the portion of land on which the residence is located exists as the result of the subdivision of the title to a larger portion of land into separate titles for use for residential purposes;
- (b) property that is common between the residence and one or more other portions of land is managed by a single body corporate (however described).

There have been no issues raised by ICA members with regard to the incorporation of this definition in the regulation. On this basis the ICA supports the definition in its present format.

Regulation 29B Small businesses

The ICA notes the intention that the standard definition for flood should apply to businesses that are sufficiently small that *they are likely to purchase insurance directly*. Government has proposed that a business should be considered 'small' where

...annual turnover is less than \$1 million **or** the business has five or fewer employees.

ICA members who provide commercial policies have flagged many issues that would require resolution in order for the regulation to be practical, for example;

- When is the turnover value measured relative to the start date of the policy?
- Should estimates be used or historic actuals?
- What happens when a turnover (estimated or actual or whatever) was above \$1m when the policy was taken out and has dropped to below \$1m at the time of a loss?
- Who is counted as an "employee"? How are part time workers counted?
- At what time is the employee count done relative to the start date of the policy?
- Either size condition triggers the requirement for use of the standard definition. A very large turnover could be included as a small business if most of the work force is sourced via labour hire/contractors and if these are not counted as an employee.
- How are the terms at 29D(2) "for the purposes of entering into a contract" to be interpreted in a practical sense. The Act defines "entering into" to include variation, renewal, extension and reinstatement of the policy. Therefore at each of these points will the insurer have to take steps to ensure the business is not a "small business" and then, if it is, clearly inform the insured in writing whether the policy provides insurance cover in respect of loss or damage caused by or resulting from flood as defined by the Regulations? This would create an administration burden on insurers leading to higher costs and frustrate insureds.
- Regulation 29(D)(2) requires the insurer to take "reasonable steps" to ensure the business is not a "small business" as defined by the Regulations. What does "reasonable steps" mean? How will this requirement work with the existing non disclosure and misrepresentations provisions of the Insurance Contracts Act 1984 which place the onus on the insured to provide information and do so truthfully? These issues need to be clarified to prevent uncertainty and unforeseen consequences.
- If there is a home and contents component to a business policy (some retail business policies have these components- including those that may not be captured under the current proposed definition of small business) and flood insurance is compulsory for home and contents insurance (a matter still being consulted on) will the insurer be obliged to provide flood insurance under the home and contents component?

Further:

- A review of current commercial policyholders by insurers shows that the majority of businesses who insure in Australia through a broker network will be captured by the definition. Where a business uses a broker the ICA considers that an appropriate and considered dialogue regarding the terms of the policy has been able to be undertaken and the business owner and broker may seek to tailor the terms of the contract to better suit the businesses specific circumstances and needs. Therefore the ICA submits commercial insurance products that are sold through FSRA licensed brokers or agents are exempt from the regulation.
- The proposed definition for small business will capture many Industrial and Special Risk (ISR) policies. ISR clients are typically commercially sophisticated, have bespoke insurance needs that do not fit into standard packages, and are quite capable of negotiating with ISR insurers and brokers to achieve a bespoke insurance outcome. The present definition of small business would force many of these businesses into insurance policies that do not suit their business circumstances. Therefore the ICA submits ISR insurance contracts be exempt from the regulation regardless of business size.
- The proposed definition for small business will capture policies that are not business specific but sold to businesses as well as individuals, for example motor policies. This will be problematic because when policies of this nature (that are captured by the Insurance Contracts Act 1984) are sold to an entity the insurer will:
 - need to take reasonable steps to determine if they are a small business (Regulation 29(D)(2), and
 - if they are a small business:
 - ensure that the flood definition as prescribed in the Regulations is inserted into that entity's policy if the word flood is used (s37B of the Bill)
 - clearly inform the entity whether or not the policy provides flood cover as defined by the Regulations even if the policy has nothing to do with water damage (s37C of the Bill)
 - the insurer will be deemed to have provided flood cover as defined in the Regulations if they include any aspect of the flood definition outlined in the Regulations in the policy (s37D of the Bill)

The above will be burdensome for the insurer and frustrate the insured.

Given all the issues outlined above in relation to including "small business" in the definition of "prescribed contract" for the purposes of the Bill it is submitted any decision in relation to including small business in the definition be delayed until all issues are appropriately considered and ventilated.

Regulation 29D Meaning of 'flood' in prescribed contracts

The proposed wording of the standard definition for flood is acceptable to the majority of insurers, with the exception of confusion caused by including natural water courses whilst not including man-made water courses.

The proposed definition includes a "canal". However the Explanatory Statement to the Regulations specifically identifies that the definition does not encompass the release of water from man-made watercourses, stating that it is expected that insurers will cover losses from the release of water from man-made watercourses as part of the cover they provide for storm damage (see page 6 of the Explanatory Statement).

However, a canal can be a man-made watercourse. The Macquarie Dictionary defines canal as "an artificial waterway for navigation, drainage, irrigation etc". Therefore storm water channels could be regarded as canals. This will introduce confusion for consumers and in some instances defeat the purpose of having a common definition.

It is confusing to customers to define flood to include escape or release of water only from natural watercourses (whether altered or modified). A customer would expect escape or release of water from storm water channel or canal to be included in a definition of flood.

This issue becomes an acute problem where flood is an opt out option and the insured has chosen to opt out of the cover. Problems requiring adjudication could arise if the storm water channel was built to take water along the same or similar path as a creek or natural watercourse. Would this be an altered creek or altered natural watercourse and thus captured by the definition of "flood"? Man-made watercourses are typically canals or storm water channels that have been constructed on top of natural water courses and features. Whilst it is arguable that these other sources are captured by the definition and the catch all term *whether or not it as been altered or modified*, for the sake of clarity and reduction in disputes it would be preferable to specifically capture the term.

The ICA submits that this confusion could be removed from the definition by one of the following options:

1. Specifically include the term *man-made watercourses* in the definition for flood, or
2. Simplify the term *natural watercourses* in the definition by removing the term *natural*, leaving it simply as *watercourses*.

The interaction between the definition of flood in the Regulations and sections 37D(1), (2) and (3) of the Bill may result in insurers being required to provide complete flood cover as defined by the Regulations if any flood event referred to in the definition is captured under another water event such as storm. This will discourage insurers from extending cover to other water events where flood is excluded in the policy. For example an insurer will not want to risk offering escape of water from a storm water channel in their storm cover for as noted above a storm water channel may be a canal and, if a canal, then the insurer will be deemed to have offered complete flood cover as defined in Regulations even though they have excluded it. This is because "canal" is included in the definition of flood in the Regulations and sections 37(D)(1), (2) and (3) will therefore deem the insurer to have provided all the flood cover as defined in the Regulations.

If you require any further information, please contact Mr Karl Sullivan, General Manager Policy Risk & Disaster Planning on (02) 9253 5155 or ksullivan@insurancecouncil.com.au

Yours sincerely



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