Insurance Council of Australia

10 April 2024

Insurance Unit
Financial System Division
The Treasury
Langton Crescent
PARKES ACT 2600

Via email: standarddefinitions@treasury.gov.au

Dear Sir/Madam

Standardising natural hazard definitions and reviewing standard cover for insurance

The Insurance Council of Australia (Insurance Council) and its members welcome the opportunity to comment on Treasury's consultation paper, *Standardising natural hazard definitions and reviewing standard cover for insurance* (the Consultation Paper).

The Insurance Council is the representative body for the general insurance industry in Australia and represents approximately 89% of private sector general insurers. Our membership is diverse, ranging from large ASX-listed companies to medium and smaller insurers who offer bespoke products.

General insurers perform a critical role in the Australian economy, assisting individuals, small business and communities to become more resilient and financially recover from loss or damage to their insured assets (for example car, home and contents, or an investment property).

General insurers operate within a highly regulated and complex field, balancing domestic legislative and regulatory requirements with contractual agreements with reinsurers operating in a global context. As a result, changes to regulatory or legislative requirements in Australia can have significant and potentially costly impacts on the operations of general insurers, including being required to make significant changes to product disclosure documentation, marketing material, and other documentation, processes, and systems.

Further, changes such as the ones proposed in this consultation paper may have an impact on insurer's contracts and ability to negotiate with their reinsurers which are typical global companies operating in many jurisdictions. If something happens in another territory the international reinsurance market may respond to peril definitions to which the insurers cannot respond anymore. For example, a wildfire in another jurisdiction could cause the international reinsurance market to revisit the insurability parameters of conflagrations and they have to apply a consistent definition in their treaties. If a primary insurer has a regulatory veto in adapting to these definitions then they would have to declare non concurrency to a regulator and possible issues with their Reinsurance declarations to APRA.

At the outset, we note that Insurance Council members hold diverse views on the benefits of greater standardisation and the standard cover regime, and anticipate that individual members will make separate contributions to this process. The cost and administrative burden of updating or changing policies and policy documents to accommodate standard definitions or a re-worked standard cover regime will be significant and cause disproportionate challenges for some of our smaller members. This should be considered carefully in the context of affordability and accessibility of coverage.

Notwithstanding these concerns, general insurers welcome the Treasury's objectives to improve customer understanding and protection. We also welcome Treasury's acknowledgement of the broader context of insurance affordability such as the global trend of rising insurance costs due to global factors including increased natural hazard events and asset price inflation, and that any policy positions adopted should consider the impact of changes to the affordability of insurance. We make the following further comments on the proposals contained in the Consultation Paper for your consideration.

Existing activity to address the protection gap

General insurers are acutely aware that home owners at high risk of natural perils events and households most exposed to rising insurance costs and the resulting protection gap are often those with greater social or economic disadvantage.[1] General insurers have been working with governments across Australia to examine the complex nature of protection gaps and collaborate on ways to address those. In particular, Insurance Council members have been actively engaging with the Australian Government on various measures designed to address the protection gap, and particularly through the Hazards Insurance Partnership (HIP) to work to address natural hazard risks resulting in rising insurance premiums.[2]

Individual insurers have also been working closely with the Government and organisations such as the Resilient Building Council to develop tools that will assist customers understand risk factors driving premium pricing, and then assess and improve the resilience of their homes, with premium discounts offered for those with higher ratings.[3]

The Insurance Council also continues our advocacy around the removal of taxes and duties on insurance premiums, and welcome the recent announcement of the NSW Government's intention to remove the Emergency Services Levy on premiums.

In addition to these initiatives, we reiterate calls for greater investment in resilience and mitigation initiatives to reduce risk and help manage rising insurance premiums.

Consumer choice

Any move to ensure greater comparability of products through standardisation or other means must still allow sufficient scope and flexibility for consumers to exercise choice in relation the products they purchase, particularly where coverage choices may have an impact on the price consumers pay for their insurance.

We also note that too great a standardisation of terms across insurance policies may lead to reduced capacity for insurers to compete on metrics outside of price. Consideration should therefore be given to ensuring standardisation does not lead to a reduction in capacity to compete across the sector, as this has the potential to lead to poorer consumer outcomes.

Financial literacy and advice regime

General insurers agree that a fair and well-functioning insurance sector requires consumers to be well informed. We acknowledge recent commentary by CHOICE pointing to the unintentional underinsurance that may flow from a misunderstanding of the cover being purchased[4], and the Australian Competition and Consumer Commission's commentary in their 2020 Northern Australia

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[1] Actuaries Institute, August 2022, *Home Insurance Affordability and socioeconomic equity in a changing climate: Green Paper*.
[2] National Emergency Management Agency, *Hazards Insurance Partnership*.
[3] The Hon. Murray Watt MP, 21 March 2024, joint media release with the Resilient Building Council, *Government-funded app delivers insurance savings*.
[4] CHOICE, 2023, *Weathering the storm: Insurance in a changing climate*.

Insurance Inquiry Report that inconsistencies in how insurers define certain terms were limiting consumers' ability to make effective comparisons between policies.[5] We also note commentary in the recently released House of Representatives Standing Committee on Economics *Better Competition, Better Prices* report highlighting potential benefits of uniform definitions in insurance policies.[6]

Insurers strive to ensure their policies and products are as clear and navigable as possible for consumers while ensuring compliance with the robust and complex regulatory framework. Noting the complexity of the environment insurers are required to operate in, we welcome the opportunity presented by this consultation to enhance consumer understanding.

While standardisation of some terms may assist some consumers in comparing products, the low to average financial literacy rate in Australia[7] and lack of understanding of key risk drivers, may present ongoing challenges to adequate consumer understanding of financial products. Where consumers do not engage with, or do not understand PDS documents, for example, or do not understand or work to mitigate the risks driving increases in premiums, standardisation of terms alone is unlikely to provide significant consumer benefit. As such, the Insurance Council recommends broader and ongoing consideration be given to uplifting financial literacy education standards and understanding of risk drivers in Australia.

Another issue directly related to consumer understanding of insurance products is insurers' capacity to provide advice on products to consumers. The extensive commentary by Michelle Levy in her report on the advice regime, highlights the need for consumers to be able to receive advice from insurers, and the current impediments to provision of that advice.[8] While general insurers have welcomed the Government's intent to reform the current advice regime to allow for better and more satisfying conversations with consumers, and support any moves to ensure insurers are not restricted in having meaningful conversations with consumers around things such as excesses and mitigation measures. We would urge the Government to consider the advice regime reforms in relation to aims of improved consumer understanding of insurance policy terms.

Standardisation and affordability

We note suggestions that greater standardisation of terms will lead to increased comparability, reduction in disputes, and ultimately greater affordability of insurance products. As noted above, the sector welcomes and supports initiatives that may assist in improving consumer understanding of insurance products, and in reducing insurance premium price pressures for consumers.

We are concerned, however, that standardisation of terms will be unlikely to achieve premium reductions in isolation. Despite a standard definition of flood being introduced in June 2012, we have not seen a reduction in flood premiums across the country. This is due to the impacts of climate change leading to intensification of short-duration rainfall intensities, increased urbanisation, increased hard surface sealing, legacy planning issues, and the underlying risk not being adequately addressed across the insured population, leading to an increase in the frequency of, and cost of recovery from natural disasters.

As such, and noting that the drivers of the protection gap are complex and multifaceted, work on mitigation activities to address the underlying risks of any of the terms proposed for standardisation will need to be progressed at pace in order for any stabilisation of pricing to be achieved.

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[5] ACCC, 2020, Northern Australia Insurance Inquiry Final Report.
[6] House of Representatives Standing Committee on Economics, March 2024, *Better Competition, Better Prices: Report on the inquiry into promoting economic dynamism, competition and business formation*, p13.
[7] Allianz, July 2023, Playing with a squared ball: the financial literacy gender gap.
[8] Michelle Levy, December 2022, Quality of Advice Review: Final Report.

Intent of the standard cover regime

In any discussion of the efficacy of the current standard cover regime, it is important to clearly define the policy objective or intent of the regime, so that amendments or reforms can be appropriately targeted to address consumer challenges.

We note that the original intent of the standard cover regime was not to standardise policies. Rather, it was to bring to a consumer's attention any exclusions and limitations which they might not expect to be in a contract. The provisions were introduced in large part to address information asymmetry between insurers and consumers prior to the introduction of the financial services disclosure regime in 2001.[9] Insurance Council members suggest that it would be beneficial for clarity to be provided on whether this intent remains, or whether the intent of the current proposed reforms is to move towards standardisation.

Responses to Consultation Questions

Insurance Council members may have differing views on some of these questions and may provide individual submissions to the Treasury for additional context.

1. **To what extent is consumer misunderstanding of insurance policies leading to unintentional underinsurance or inappropriate insurance?**

   Underinsurance and inappropriate insurance is a complex matter that has many causes. Intentional underinsurance can be driven by a consumer's risk appetite or a decision resulting from pricing of policies. Unintentional underinsurance can be driven by a lack of understanding of the nature of indemnity cover, exclusions such as those related to maintenance obligations, cost of rebuilding or replacing items, a failure to adequately assess the risks affecting an asset, or a failure to understand the policy more broadly.

   Consumer misunderstanding of insurance policies may be a contributing factor to unintentional underinsurance or inappropriate insurance but is not the highest order contributing factor, and it is unlikely that standardisation of natural perils definitions alone will resolve this issue.

2. **What are the consequences of not addressing these issues?**

   Unintentional underinsurance can have negative consequences for consumers who need to make a claim. It also has broader implications due to the key role of insurers in lessening financial burdens in the wake of disasters for governments and communities. The general insurance sector is committed to working with the Government to improve consumer outcomes, and as such, welcomes steps to address issues that may contribute to unintentional underinsurance. For example, and as highlighted previously, addressing issues of poor financial literacy a lack of understanding of risk drivers, and the current restrictions in the advice regime would be of benefit.

3. **What other interventions may increase consumer understanding of insurance cover?**

   As highlighted previously, general insurers are concerned that standardisation of definitions will not, in isolation, increase consumer understanding of insurance cover sufficient to see an end to underinsurance or inappropriate insurance. We note a number of initiatives at industry level, including the use of sum insured calculators and general information provided to consumers via insurer websites and the Insurance Council, are already seeking to support efforts and interventions to increase consumer understanding.

[9] Insurance Council of Australia, October 2018, *Submission to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry: Policy Questions Arising from Module 6*.

Other possible interventions include improving financial literacy education, ensuring greater consumer understanding of risk drivers, and the ensuring advice regime settings are fit for purpose. Further, ongoing activities such as engagement in the HIP, and continual review of regulatory settings to ensure general insurers can innovate and provide products that give consumers flexibility of choice and provide transparency on metrics other than price are critical.

In addition, a review of the disclosure regime may be beneficial. The level of detail required to comply with the current regime can result in very large and complicated disclosure documents, which may not be ideally accessible to consumers.

4. **Do you agree with the priority terms that are proposed for standardisation?**

Notwithstanding previously highlighted concerns that standardisation alone may not produce the consumer benefits sought, we welcome further consultation on the priority terms identified.

5. **Are there any exclusions that you believe should apply?**

Any exclusions would need to be considered in the context of the priority terms and definitions as they are developed.

6. **Are there any additional natural hazard terms you think should be standardised?**

While not a consensus view across general insurers, some members have suggested that it may be beneficial to include 'storm surge' in the priority definitions to ensure that all water from the ground up is considered. Again, while not a consensus view, some members have also suggested there may be benefit to including 'actions of the sea'.

We acknowledge the explicit exclusion of maintenance/wear and tear clauses from the scope of this paper, and the acknowledgement of the independent work being undertaken by the Insurance Council in this space.

7. **How well is the current standard cover regime achieving its intended purpose?**

As highlighted above, we are keen to see the policy objective or intent of the regime clearly defined, so that amendments or reforms can be appropriately targeted.

We note commentary in the Consultation Paper that consumer and industry groups have overall indicated that the current standard cover regime is not fit for its purpose, in large part because insurers can derogate from the standard if they disclose that they are doing so. Analysis by some members suggests that insurers do not deviate significantly from the standard cover regime against their home insurance products. Rather, the standard cover regime sets out covers (and exclusions) at a very high level, and while this is generally provided, the detail of cover is where that coverage can vary considerably.

For example, under the standard cover regime, "fire" is a prescribed event. However, the regulations do not provide any further definitions around this cover. As such, an insurer may provide that cover will, for example, exclude loss or damage:

- which arises gradually out of repeated exposure to fire or smoke,
- of an item that is designed to be exposed to heat, being exposed to heat during normal use – for example if a heat resistant item like a cooking appliance or fireplace is damaged during normal use, or
- to any property as a result of scorching and/or melting – for example, cigarette burns (although this exclusion would not apply if the scorching and/or melting was a direct result of a fire covered under the policy).

Therefore, the limitations in the current regime go more to lack of clarity around definitions on key aspects of cover, rather than the regime not prescribing the right types of cover or the ability of insurers to derogate.

Despite this, Insurance Council members are not aligned on whether a more prescriptive regime will benefit consumers, and we reiterate previous comments about the need to ensure a flexible regime that promotes product innovation, flexibility, and consumer choice over restrictive requirements.

8. **Which of the three options for intervention would best achieve the intended purpose?**

   Noting the commentary about the operation of the standard cover regime at question 7 above, members have provided feedback that, subject to clarification of the intent of the regime, options one and three may not achieve the policy objective. Members are open to exploring the potential merits of option two, amending the standard cover regime to mandate a baseline level of coverage for home building insurance only, although there is no clear consensus on whether this option will in fact achieve the intended purpose.

   Critically, any 'mandated' cover will need to be carefully considered to ensure that it continues to allow for flexibility, affordability, consumer choice, and does not result in a requirement for insurers to provide cover that they would not otherwise have the appetite to provide. For example, some members have indicated that they would not support a standard cover regime that required insurers offering 'opt out' of certain covers, where they otherwise do not allow customer to do so.

   Equally, if a mandated cover is applied, insurers should still be permitted to deviate from the standard cover if in doing so they clearly inform the customer of the deviation. This would serve to provide some much needed flexibility in the regime.

   We do note, however, the limitations and challenges inherent in the high level nature of the cover requirements under the regime, and the need for ongoing reform.

9. **Which of the three options is least likely to achieve the intended purpose?**

   Members have indicated that option three is unlikely to achieve the intended purpose and should not be pursued.

   Subject to clarification of the intent of the regime, option one may remain relevant.

10. **Are there any other options to amend standard cover that should be considered?**

    Given our commentary in response to question 7, while there is not currently a consensus view amongst Insurance Council members, a new or amended option two may be feasible by retaining elements of the existing standard cover regime, and considering providing greater clarity of expected coverage, subject to our comments in response to question 8.

    Insurance Council Members consider that additional consideration should also be given to alternatives that promote comparability and transparency to drive better consumer outcomes.

11. **Should the standard cover regime be retained for insurance products other than home insurance?**

    Consideration should be given to various commercial insurance products that may come within the scope of home insurance. Any reform progressed should consider the breadth of product types potentially impacted, and the customer needs of those products to determine whether the scope of the reform should extend to them.

We welcome further engagement with Treasury on any further consultation on standardised natural perils definitions or a review of the standard cover regime. If you have any further queries, please feel free to contact Ms Alexandra Hordern, General Manager, Regulatory & Consumer Policy, at ahordern@insurancecouncil.com.au or on 0411 281 790.

Yours sincerely,

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