Too Long; Didn't Read

Enhancing General Insurance Disclosure

Report of the Effective Disclosure Taskforce to Insurance Council Board

October 2015

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INSURANCE COUNCIL OF AUSTRALIA

Mr Andy Cornish
President
Insurance Council of Australia
Level 4, 56 Pitt Street
SYDNEY

29 October 2015

Dear Mr Cornish

On behalf of the Effective Disclosure Taskforce, I am very pleased to provide this Report, which incorporates the Taskforce's work over the past four months and its recommendations. Our thanks to you and the Insurance Council for giving us the opportunity to do so.

The average general insurance consumer is an Australian who purchases an insurance policy, at least one. The purchase is usually from an Australian Authorised General Insurer. The consumer's objective is to protect assets usually accumulated over a period of time. The principal asset is usually a dwelling, which is often subject to a mortgage.

A financial or other catastrophe over the course of the life of an average Australian could mean that full recovery is never achieved or the family never achieves an anticipated lifestyle. Thus, general insurance products and their support by the general insurance industry are critical in and for the life of the average Australian.

If those insurance products do not, for example, restore property following a loss and in a timely fashion, Australians may never recover their financial position or achieve their expectations for quality of life and security.

Thus Australians need to purchase their insurance protection wisely. They should have a reasonable understanding of what their needs are, and thus be able to make decisions about how the product purchased will restore their assets following a loss. This includes being as sure as they can be that the amount of cover they purchase (including any sub-limits) is what will be needed to achieve the desired restoration.

Finally, to some extent, they need to be able to differentiate between competing products and not just on the basis of price. They need to have an appreciation of cover they don't need, as well as cover they do need.

There is recognition within the Australian insurance industry of the central importance of their products to the life of the average Australian.

The contracts within which these products are contained are no longer arm's length relationships governed by notions of 'let the buyer beware' (caveat emptor). The Code of Practice, utmost good faith, decades of regulation and voluntary schemes for dispute resolution are all recognitions that the Australian insurance industry sees this importance. Indeed, it has led some of them.

Not everyone can be an insurance expert. Insurance terminology is difficult. Insurance law is complex. And the English language, with its uncertainties and vagaries, will always present challenges.

Thus the industry has a role in being the principal provider of assistance to ensure that the average Australian gets the product that they truly need.

Many initiatives (by legislation, regulators, the insurers themselves, as well as industry bodies) have been adopted over many years to better inform Australian consumers and aid the education process to enable better decision-making about the purchase of general insurance.

We do not doubt that those initiatives were genuine and well-meaning. However, we have found no hard evidence, due to the lack of empirical data, to demonstrate their success, either in a general sense or with individual Australian consumers.

Hopefully this Report will be the commencement of the much needed benchmarking and research to enable better answers to those questions, something more than anecdotes and one-off examples.

To this point, efforts have largely focused on legal and compliance imperatives to provide accurate information which was, in some sense, clear. The behavioural science contribution to the work of this Taskforce has significantly refocused attention on communication outcomes, rather than simple well-meaning legal tests.

Again, hopefully, the work of this Taskforce will result in the provision of information and messages which actually help individual Australians make better decisions for the protection of their assets and to sustain their lives.

The work of this Taskforce has also led to a realisation that the effective disclosure document cannot be considered remote from the subject matter of the disclosure. In other words, the complication of insurance wordings and the constant remedying of unforeseen outcomes is a critical part of the role of the insurance industry in delivering more certainty to Australian consumers and closing the expectations gap.

For this reason the challenge of wordings which have more standard provisions (flood and terrorism are recent examples) and more certainty about the adequacy of the sums insured must remain on the table for further consideration. Hopefully the future capture of more reliable information about claims and risk, cost and incidence, will provide the industry (including the reinsurers) with more confidence for new approaches to these challenges.

Although the work of the Taskforce was focused on a limited area of insurance and types of policies, it has raised a number of important issues and underscored the reality that these particular issues never stand still for long, if at all. It really is one of constant review. Getting to a position which is satisfactory for Australian consumers, and the Australian industry is something that requires open minds, growing unity of purpose, sharing of information and understanding of the key issues from both sides. It must always be work in progress for those reasons.

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The Taskforce has identified many initiatives to be carried forward. Time simply did not permit us to do more. We certainly hope the work of this Taskforce has better informed all of the stakeholders but more importantly we hope its success will be measured by the way in which the members of the Taskforce and the members of the Insurance Council secretariat were capable of working constructively and harmoniously together to produce an outcome that we trust covers our brief, stimulates thought and provides part of the way forward – at least for now.

It is against this background and on these premises that we present this Report.

I would like to express my appreciation to the members of the Taskforce (Ravi Dutta, Tracy Green, Chris Harnett, Ben Honan, David Leermakers and Gail Pearson) and the Insurance Council secretariat (John Anning and Denise Hang) for the enthusiasm and openness in which they approached the work of the Taskforce.

Yours sincerely

Michael Gill

Michael Gill
Chair
For and on behalf of the Effective Disclosure Taskforce

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1. Executive Summary

Too long; didn't read or "TL;DR" is an internet slang term often used to respond to posts that are unnecessarily lengthy and detailed. It is used by readers to signal their attention has been lost because the post is not interesting or personally relevant enough to justify its length. It is a sign the author has not adequately considered the needs and motivations of their audience and has failed to break through the barrier of information overload.

TL;DR can be applied to general insurance disclosures. Mandated disclosure documents are not interesting or relevant enough to capture the attention of consumers before a purchase decision is made. As a result, the disclosure regime is not meeting its primary objective of helping consumers buy insurance that meets their needs.

This appears to be a challenge for consumer contracts of all kinds around the world. Delivering information at the right time, and in the right way, to improve decision-making is complex.

A literature review of insurance disclosure research reveals a notable absence of empirical research around how consumers actually use disclosure documents to inform their decision-making. Research conducted to date is significantly weakened by its reliance on consumers self-reporting through surveys.

As a result, there is virtually no understanding of what the actual impact of disclosure is. The needs and motivations of the audience are not being adequately considered.

The lack of empirical research has been a significant barrier to the Effective Disclosure Taskforce (the Taskforce) being able to reach firm conclusions about the effectiveness of disclosure. More importantly, it is a significant barrier to the industry and government improving disclosure over time.

To ensure that future reforms have positive impacts, it will be necessary to establish a benchmark of current disclosure and to test the impact of future changes on consumers before implementing them. Failure to do so could potentially see industry incur significant cost to implement reforms that are ineffective - or worse, actively harmful to consumers. The Taskforce is recommending that a substantial research work program is conducted by the Insurance Council.

More research is required to make an informed assessment of the effectiveness of disclosure. The Taskforce recommends that further research is conducted into how consumers actually use insurance disclosures and the impact of these disclosures on decision-making at and around the point of sale. In order to establish a benchmark to evaluate the effectiveness of future initiatives to improve disclosure, current consumer knowledge and understanding of commonly purchased insurance products should also be measured.

While disclosure currently serves a range of purposes, the Taskforce considers that the primary objective of disclosure should be to help consumers purchase a general insurance policy appropriate to their needs.

The Taskforce considers that a major shortcoming in the disclosure regime has been its sole focus on the provision of information, without the necessary regard for the consumer's ability to make use of that information.

In this regard, a distinction should be drawn between mandated disclosure and effective disclosure. Mandated disclosure sets the minimum benchmark required by law. However, effective disclosure cannot be achieved simply by reference to the minimum legal requirements. Effective disclosure needs to be informed by the core concept of transparency; information that encourages effective decision-making and is of more relevance to the individual.

The Taskforce is recommending that industry, working with regulators and government, should shift its mindset from tick-a-box compliance towards developing disclosure that engages consumers and helps them to make decisions about their insurance needs.

The Taskforce was specifically asked to consider the Financial System Inquiry (FSI) recommendation to improve guidance (including tools and calculators) and disclosure for general insurance, especially in relation to home insurance. The Taskforce supports the FSI recommendation and believes that, at a minimum, the industry should ensure that sum insured calculators are integrated into the sales process for home building so that consumers are given free and automatic guidance prior to selecting their sum insured. The industry should also seek to improve the accuracy of home building and home contents sum insured calculators and consider incentives to encourage their use including upon renewal.

The related Productivity Commission recommendation for insurers to disclose natural hazard risk information to households was also considered. Natural hazard information is essential for households to make plans and take action to protect life and assets, and the Government bears prime responsibility for making the information it holds available to the public. Insurers use risk data from a wide variety of sources to inform their own unique and commercial assessment of risk. The disclosure of different and conflicting risk assessments by individual insurers is likely to cause confusion. It is understood however, that the creation of a government portal for hazard data is unlikely to be concluded in the near term. As such, the Taskforce believes that the industry should test how natural hazard data held by insurers can be effectively provided to consumers in an informative and constructive fashion.

In considering the mandated disclosure regime, the Taskforce found insufficient evidence to warrant any radical reforms. While the need for reform will be further informed by the research program that the Taskforce is recommending, what appears to be needed at the pre-contractual stage is information/prompts to consider particular issues relevant to a consumer, which is made available through a variety of channels. Electronic forms of disclosure also have the potential to enable insurers to better target information that is relevant to a consumer. Insurers should actively explore and adopt new forms of electronic disclosure that enable information to be delivered in more relevant and personalised ways. This will be facilitated by appropriate law reform to enable electronic communication as the default method of providing insurance product disclosure.

More meaningful engagement with consumers will also be facilitated by a reconsideration of how the financial advice regime applies to the general insurance industry. The Australian Securities and Investment Commission (ASIC) should provide regulatory guidance, and where necessary relief, to support the provision of guidance, and where required advice, to consumers purchasing general insurance products.

The Taskforce acknowledges the report released by the Australian Consumer and Competition Commission (ACCC), *Information and informed decision making*, on disclosure in the health insurance sector. While the report should provide useful insights into the effective use of disclosure generally, it was released when the Taskforce was concluding its work and therefore was unable to consider its findings.

In responding to the terms of reference set by the Board of the Insurance Council of Australia (the Insurance Council), the Taskforce has attempted to deliver a strategic plan for the industry in ensuring that disclosure is fit for purpose and fulfils a relevant and useful purpose in the coming years. This report is only the first step in a longer term work program, which will require collaboration between the industry, regulators, government and consumer stakeholders.

2. Summary of Recommendations

The Taskforce has considered disclosure from a broad perspective and in the context of retail[1] consumers only. The recommendations in this report are intended for retail general insurance products, however, the principles may have broader applicability.

These recommendations are intended to be implemented as a whole and are interrelated. **Diagram 1** illustrates the interaction between the recommendations.

An indicative timeline has been established to guide work on each of the recommendations. Timing has not been suggested for the recommendations (9, 11, 12 and 13) dependent on law reform or regulatory guidance. The Taskforce recommends that the Insurance Council's Board should continually monitor progress, and should report on achievements and future plans after 12 months.

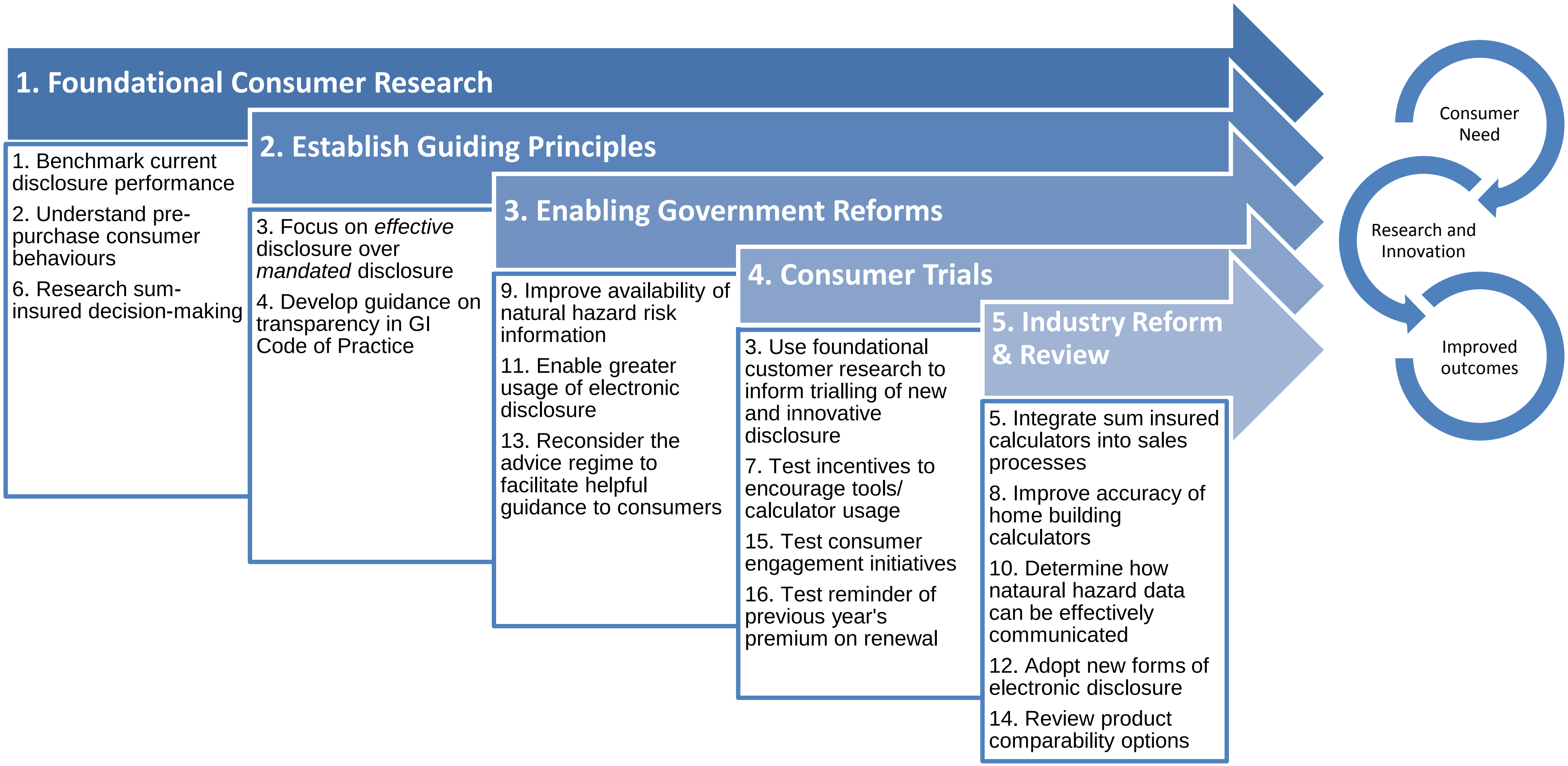
	Recommendation	**Timeline**
1.	The Insurance Council should establish a disclosure performance benchmark by commissioning and publishing research on current consumer knowledge and understanding of commonly purchased general insurance. The research should be based on observations of actual behaviour rather than consumer self-reporting, and be used to measure the effectiveness of future initiatives.	Short term
2.	The Insurance Council should commission and publish research to determine pre-purchase consumer behaviours and how disclosure can be used to nudge appropriate decision-making. This research should be based on observations of actual behaviour rather than consumer self-reporting.	Short term
3.	The industry should shift from a minimum mandated disclosure approach to best practice transparency to better assist consumers to choose a product that meets their needs. Research to be commissioned by the Insurance Council should inform insurer trialling of new and innovative disclosure tools and techniques.	Medium term
4.	The Insurance Council should consolidate the insights from research to be commissioned to develop guidance under the General Insurance Code of Practice on the principles of transparency in fulfilling the Code's objectives around "more informed relations" between insurers and their customers and promoting "trust and confidence" in the industry.	Medium term
5.	Insurers should integrate sum insured calculators into the sales process for home building so that consumers are provided free and automatic guidance prior to selecting their sum insured.	Medium term

[1] "Retail insurance" as defined by the General Insurance Code of Practice, http://codeofpractice.com.au/assets/documents/Code%20of%20Practice.pdf, p. 22.

	Insurers should be able to report substantial progress on this recommendation within 12 months of the release of this Report.	
6.	The Insurance Council should research consumer behaviours in relation to decision-making about the sum insured for home building insurance to inform development, and create ongoing improvement, of sum insured calculators.	Short term
7.	Insurers should actively explore the use of incentives to encourage greater use of sum insured calculators in home building and home contents insurance, particularly for renewing customers.	Medium term
8.	The Insurance Council and insurers should work with data providers to develop an enhanced sum insured calculator for building insurance that can be used as the industry standard. The Insurance Council should be able to report substantial progress on this recommendation within 12 months of the release of this Report.	Short term
9.	The Insurance Council should continue to press government to make natural hazard risk information available and accessible via a centralised portal to better inform the community of their risks.	
10.	The Insurance Council should establish a committee to determine how natural hazard data held by industry can be effectively provided to consumers in a consistent format to improve their understanding of natural hazard risks specific to their homes. The Insurance Council should be able to report substantial progress on this recommendation within 12 months of the release of this Report.	Short term
11.	The Insurance Council and industry should seek law reform to enable electronic communication as the default method of providing insurance product disclosure, consistent with current regulation of other financial product disclosures.	
12.	Insurers should explore and adopt new forms of electronic disclosure that enable information to be delivered in more relevant and personalised ways.	
13.	The Insurance Council and industry should work with ASIC and the Government to improve the advice regime in order to enable the disclosure of more targeted information to consumers. The Insurance Council should be able to report substantial progress on this recommendation within 12 months of the release of this Report.	
14.	The Insurance Council and the industry should conduct a review of product comparability options to identify methods of improving consumer understanding of coverage differences between products.	Medium term

15.	Insurers should actively identify opportunities for constructive and useful engagement with consumers through the life of a product to enhance consumer engagement.	Medium term
16.	The Insurance Council should coordinate trialling of the provision of a reminder of the previous year's premium at each renewal.	Medium term

Diagram 1: Five step reform pathway



3. Background

The FSI brought renewed public attention to long standing concerns about the efficacy of disclosure, both mandated and insurer initiated, to help consumers[2] make informed decisions when buying general insurance. Disclosure documents are perceived by industry, government and consumer groups to be overly complex, lengthy and ineffective in enabling consumers to make informed choices at the point of sale. A focus by both regulators and insurers on compliance with the rules, rather than consumer understanding, has resulted in disclosure documents that are designed more to manage the insurer's liability than inform the consumer.

The Insurance Council, in its response to the FSI's Interim Report, indicated that it will lead an industry project to improve disclosure outcomes. In July 2015, the Insurance Council's Board established the Taskforce composed of industry and non-industry representatives as the first step in delivering on this commitment.

The Taskforce was provided with the following terms of reference:

1. The Taskforce will advise the Insurance Council's Board on initiatives that could be undertaken to raise the effectiveness of disclosure in order to better equip consumers to choose general insurance products which are appropriate to their needs.
2. The Taskforce will consider the need for the Insurance Council to advocate for change in the mandated disclosure requirements (in particular the PDS and KFS) as well as in policy and practice at the industry level.
3. The Taskforce will consider the effectiveness and role of disclosure documents within the context of the broader consumer experience, such as the provision of advice, financial literacy initiatives, consumer risk assessment tools and aids, and advertising. The Taskforce's deliberations will take into account the importance of consumers being able to make valid comparisons between insurance policies.
4. The Taskforce may recommend that the Insurance Council undertake further work in areas likely to facilitate the improved effectiveness of disclosure or complement disclosure's role in promoting better consumer outcomes.
5. The Taskforce may request the Insurance Council to commission consumer research and testing to ensure that the Taskforce's work is based on an accurate assessment of how disclosure operates and that any recommendations are likely to have worthwhile consumer benefit.
6. The first priority for the Taskforce is to address Recommendation 26 of the Financial System Inquiry: Improve guidance (including tools and calculators) and disclosure for general insurance, especially in relation to home insurance.

The Taskforce was asked to deliberate on these terms, and report to the Board in November 2015. The Insurance Council provided the secretariat for the Taskforce.

This Report to the Board summarises the key observations, findings and recommendations made by the Taskforce over the past four months in considering its terms of reference. To

[2] The term "consumer" in this Report is used interchangeably with "customer", "insured" and "household".

meet its reporting deadline, the Taskforce was only able to consult with a limited range of stakeholders. The Taskforce recommends that this Report be made public after consideration by the Board, and that the recommendations be subject to wider stakeholder consultation.

More information about the composition of the Taskforce and the process undertaken in meeting its terms of reference is contained in **Annex 1**.

4. The Current Disclosure Regime

A significant portion of product and other information that general insurance consumers receive is mandated by the disclosure regime that applies to most financial services products. The Taskforce has considered disclosure from a broad perspective as consisting of disclosure that is mandated and disclosure that is insurer initiated. The Taskforce has considered disclosure in the context of retail consumers only, and the recommendations in this report are intended for retail general insurance products. However, the principles around effective disclosure may have broader applicability.

The Taskforce considers that mandated disclosure forms one component of the information relevant to specific stages of the product life-cycle. However, the overall consumer experience cannot be fully appreciated without considering other information sources, such as the material and resources provided on insurers' websites, conversations with call centre staff, quote summaries, certificates of insurance/policy schedules and policy renewal communications.

This chapter summarises the range of disclosures that general insurance consumers typically receive.

4.1. MANDATED DISCLOSURE

4.1.1. Objectives of Mandated Disclosure

The mandated disclosure regime for financial products is contained in Chapter 7 of the *Corporations Act 2001* (the Corporations Act). The objective of disclosure, as stated in the Act (section 1013D) is to provide information that "…a person would reasonably require for the purpose of making a decision, as a retail client, whether to acquire the financial product". In its guidance, ASIC also states that the broad objectives of the Product Disclosure Statement (PDS) regime are to help consumers compare and make informed choices about financial products[3].

Introduced through the broad-based Financial Services Reform (FSR) in 2001, the key motivation for the development of a mandated disclosure regime was to address the information asymmetry between consumers and financial services providers.

4.1.2 The Tailored PDS Regime for General Insurance

While the motivation behind FSR was to rationalise the regulation of financial services, it soon became apparent that a one-size-fits-all approach was not always appropriate for the general insurance sector. Shortly following FSR, a review of general insurance disclosure found that there was duplication in respect of information provided in the PDS and in the policy wording and that the documentation should be simplified and streamlined.

Accordingly, in December 2005, the PDS provisions in Part 7.9 of the Corporations Act were changed for general insurance products by the addition of Regulations 7.9.15D, 7.9.15E and

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[3] ASIC (September 2010), *Disclosure: Product Disclosure Statements (and other disclosure obligations)*, Regulatory Guide 168.

7.9.15F. The effect of the refinements was that the PDS became the whole document, incorporating the policy terms and conditions.

The tailored disclosure regime differs from that of other financial products by allowing the policy terms and conditions to be combined with the PDS, and removes the need to disclose information required of other products. The Corporations Act requires that the following content is covered in general insurance PDSs:

- a statement setting out the name and contact details of the issuer of the financial product;
- information about any significant benefits to which a holder of the product may become entitled, the circumstances in which and times at which those benefits may be provided and the way in which they may be provided;
- information about the cost of the product, any amounts that may be payable in respect of the product and the times at which they may be payable, any amounts that may be deducted from a common fund by way of fees, expenses or charges;
- information about significant characteristics or features of the product or of the rights, terms, conditions and obligations attaching to the product;
- information about the dispute resolution system that covers complaints by holders of the product and about how that system may be accessed;
- information about any cooling off regime; and
- any other statements or information required by the regulations.

The tailored general insurance disclosure regime in the Corporations Act also requires PDSs to include disclosure required under sections 35 and 37 of the *Insurance Contracts Act 1984*[4]. These additional disclosures relate to any non-standard term that differs from those for prescribed contracts, as well as any unusual term.

The tailored general insurance disclosure regime applies to the following products:

- motor vehicle insurance;
- home building insurance;
- home contents insurance;
- sickness and accident insurance;
- consumer credit insurance;
- travel insurance;
- personal and domestic property insurance; and
- any other general insurance product prescribed by the regulations, including medical indemnity insurance.

Some statutory insurance, such as compulsory third party (CTP) and workers compensation insurance, are not covered by any Commonwealth legislation (including that which requires

[4] Corporations Regulations 2001 (Reg 7.9.15E).

disclosure to consumers) because they are state insurance and beyond the legislative power of the Commonwealth Government; and therefore, are not required to be issued with PDSs. Depending on the scheme, some policies are issued with policy documents. It would be difficult to draw any lessons about the effectiveness of these alternative approaches to disclosure due to inherent product differences. The compulsory nature of these types of policies would most likely have a greater bearing on consumer behaviour, than the disclosures made by insurers about the policies.

4.1.3. Principles for Effective Disclosure

As well as the prescribed content, the Corporations Act (section 1013C(3) for PDSs and sections 942B(6A) and 942C(6C) for FSGs) requires disclosure to be worded and presented in a "clear, concise and effective" manner. ASIC has supplemented the legislative requirements with "good disclosure principles"[5], namely:

- disclosure should be timely;
- disclosure should be relevant and complete;
- disclosure should promote product understanding;
- disclosure should promote product comparison;
- disclosure should highlight important information; and
- disclosure should have regard to consumers' needs.

Despite this attempt at greater guidance, its principles-based nature is generally considered by industry to be unhelpful in reconciling the various requirements, for example, how an appropriate balance can be struck to achieve concise disclosure that is also complete.

4.1.4. Other Mandated Disclosure Requirements

In addition to the PDS, Chapter 7 of the Corporations Act also requires the provision of Financial Services Guides (FSGs) generally where financial advice (general or personal) is provided to retail clients. The key FSG content requirements include disclosure about the financial services the provider is authorised to provide; information about the remuneration, commission and other benefits the provider will receive; and any potential conflicts of interest. The FSG may be combined with the PDS and delivered as one document.

General insurers are generally exempt from the need to provide Statements of Advice (SOAs) when personal advice is provided.

4.1.5. Key Facts Sheet for Home Insurance Products

In response to the Queensland flood events in 2011, the Government introduced an additional legislative requirement for the disclosure of a Key Facts Sheet (KFS) for home building and contents insurance products. The Government has stated that the decision to

[5] ASIC (September 2010), *Disclosure: Product Disclosure Statements (and other disclosure obligations)*, Regulatory Guide 168.

introduce the KFS was made to address the reality that many consumers fail to fully read (or read at all) their PDSs prior to entering into insurance policies[6].

The *Insurance Contracts Amendment Act 2012* introduced a highly prescriptive KFS disclosure document intended to increase access to key information (such as flood coverage) and importantly facilitate comparison across products. The KFS is a one page (double-sided) document listing prescribed events (such as flood, storm, actions of the sea, etc.) and the policy's coverage in respect of each. The requirement to provide a KFS came into effect in September 2014. The earliest that any government review of the effectiveness of the KFS will take place is 2016[7].

4.1.6 Consumer Protection Framework

The disclosure framework is part of a broad range of consumer protection measures that apply to general insurance. Relevant consumer protection measures targeted at the pre-sale stage include the mandatory 14 days cooling off period for consumers and other consumer protections that apply to all products, such as protection from misleading and deceptive conduct (in the *ASIC Act 2001*). General insurance consumers also receive post-sales protections, including those provided in the Insurance Contracts Act that protect consumers from claims being denied where they have made non-fraudulent misrepresentations. Insurers are also required by legislation to have adequate internal and external dispute resolution processes.

In addition, signatories to the General Insurance Code of Practice (the Code) are subject to its service standards. The Code sets out the standards that general insurers must meet when providing services to their customers, such as being open, fair and honest. It also sets out timeframes for insurers to respond to claims, complaints and requests for information from customers.

4.1.7. Regulatory Trends

Over the past 10 years, the Government has taken an increasingly differentiated approach to disclosure across various financial products. The Shorter PDS regime has been introduced for margin lending, managed investments, super and first home saver accounts. On the other hand, the one-page KFS has been mandated for home insurance products and the long-form PDS remains for pension, life insurance and general insurance products. This approach appears to represent a significant shift away from the principles that were applied under FSR and seems to be driven by reactions to perceived individual problems rather than any clear overarching Government principles guiding the development of disclosure requirements for financial products.

As well, the discussions arising from the FSI are demonstrative of the move away from disclosure being seen as the key regulatory tool towards a more interventionist approach to the regulation of retail financial products. The FSI recommendations on strengthened product design and distribution obligations and powers for ASIC to potentially ban products, which have been accepted by the Government, are examples of this trend. In line with this, efforts to enhance the effectiveness of disclosure have been driven by a growing

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[6] Treasury (December 2012), *Insurance Key Facts Sheet*, Regulation Impact Statement.
[7] Treasury (December 2012), *Insurance Key Facts Sheet*, Regulation Impact Statement.

acknowledgement that product issuers should not only be obliged to make the prescribed disclosures, but should have greater responsibility for consumer understanding and decision-making.

4.2. OTHER SOURCES OF POLICY INFORMATION

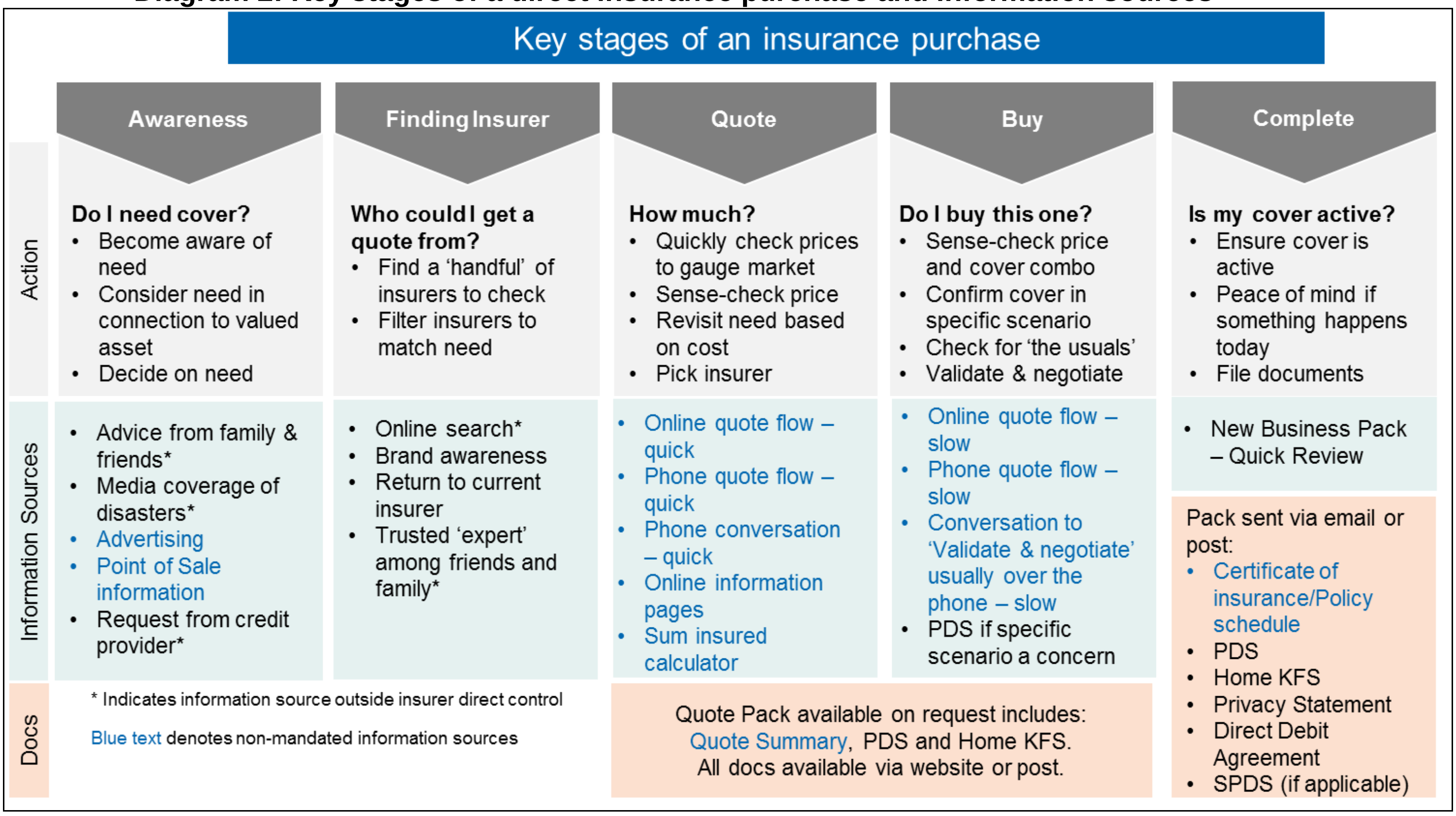
Apart from the mandated PDS and KFS (for home and contents insurance), a range of information provided by insurers is used by consumers (see **Diagram 2**).

For new policies, consumers can access information from a wide range of insurer sources, including:

- advertising;
- point of sale printed and online information;
- information disclosed through the application process (online and phone); and
- call centre facilities.

Consumers also receive a certificate of insurance or policy schedule confirming the policyholder's insurance cover including details about the type of insurance cover, the sum insured amount, excesses that apply, some important exclusions and limits, the premium and the period of insurance. It also contains a summary of key questions and answers disclosed by the policyholder. The renewal notice or certificate is a similar document issued at renewal, and may require the consumer to review and update their information.

Diagram 2: Key stages of a direct insurance purchase and information sources



For policies purchased through a broker, the disclosure documents provided will be the same. However, the consumer will also be provided with the broker's assessment and advice about individual needs, and corresponding product options and comparisons (see **Diagram 3**).

There is an increasing awareness of growing consumer empowerment enabled by widespread use of the internet, interactive digital mobile technology, and social networks. These tools are revolutionising the way consumers are informed of events (about the impact of real time emergencies), wield purchasing power (as buying groups), and influence policy outcomes (with lobbying campaigns). There is a fundamental shift occurring in the nature of the insurance industry's relationship with consumers and the way insurance is purchased. With greater access to information through technology and social networks, traditional distribution models are changing as consumers' behaviour changes from seeking advice from insurance agents and advisers to online networks and communities.

Diagram 3: Key stages of a broker-assisted insurance purchase and information sources

Key stages of an insurance purchase from a broker

	Awareness	Finding a Insurance Broker	Broker Assessment and Advice/Options	Buy	Complete
Action	**Do I need cover?** • Become aware of need • Consider need in connection to valued asset • Decide on need	**Who could I get a quote from?** • Find and select a broker for the type of cover needed • Discuss needs with broker	**How much?** • Broker will assess needs & prepare report with several products, highlights benefits & pricing of each, and then recommend one	**Do I buy this one?** • Confirm cover and price provided on selected product • Broker instructed to place the cover with the chosen insurer	**Is my cover active?** • Ensure cover is active • Peace of mind if something happens today • File documents
Information Sources	• Advice from family & friends* • Media coverage of disasters* • Advertising • Point of Sale information • Request from credit provider*	• Online search* • Brand awareness • Trusted 'expert' among friends and family*	• Quote Information Pack for product/s prepared by broker with recommendation outlined • Broker on hand to offer additional insights on market, products and insurer performance if needed	• PDS (& SPDS if applicable) if specific scenario a concern	• New Business Pack – Quick Review
Docs	* Indicates information source outside insurer direct control Blue text denotes non-mandated information sources		Quote Pack available on request includes: Quote Summary, PDS and Home KFS. All docs available via website or post.		Pack sent from Broker via email or post: • Certificate of insurance/Policy schedule • PDS • Home KFS • Privacy Statement • Direct Debit Agreement • SPDS (if applicable)

5. The Consumer Experience: What We Know

The Taskforce conducted a literature review into previous research that has attempted to measure the effectiveness of disclosure. The review found no empirical research around how general insurance consumers actually use disclosure documents and the impact of these documents on decision-making. The existing research specific to general insurance, while instructive, is constrained by their reliance on consumers self-reporting knowledge and use of disclosures. The lack of empirical research has been a significant barrier to the Taskforce being able to reach firm conclusions about the effectiveness of disclosure.

In particular, none of the research measured the extent to which, if any, the existing disclosure requirements have been of benefit to consumers in the purchase of policies.

More research is required to make an informed assessment of the effectiveness of disclosure. The Taskforce recommends that further research, based on a methodology of observing actual behaviours, is conducted into how consumers actually use insurance disclosures and their impact on decision-making at the point of sale. In order to establish a benchmark to evaluate the effectiveness of future initiatives to improve disclosure, current consumer knowledge and understanding of commonly purchased insurance products should also be measured.

5.1. HOW CONSUMERS VIEW AND USE GENERAL INSURANCE DISCLOSURE

5.1.1. UMR Research

In 2008, the Insurance Council commissioned UMR[8] to examine general insurance consumers' reactions to existing PDS documentation. Participants in the research were asked their views on a random and wide selection of PDS documentation on general insurance products. The key findings were:

- the majority of participants (71%) agreed that PDSs are often too long or difficult for many people;
- most participants skim through the document focussing on what the policy does not cover; and
- participants generally agreed they would prefer to be given shorter summaries (and also maintain a larger PDS document as it gave them comfort) but that these shorter documents incorporate key information, especially on what is not covered and expenses such as excesses.

Participants offered a broad range of "principles" which they would like insurers to pursue when preparing a PDS. These included:

- simpler and plain English documentation with no "technical terms";
- breaking the PDS into logical sections;

[8] UMR Research Pty Ltd (November 2008), *Insurance Council of Australia Community and Stakeholder Study*, Presentation to the Insurance Council Board, 13 November 2008.

- including examples of what is covered and not covered, making this clear;
- providing key information on dispute resolution mechanisms such as the Financial Ombudsman Service;
- mention of the General Insurance Code of Practice and a short explanation of the Code; and
- an additional summary document of 4 to 10 pages.

5.1.2. Inside Story Research

In 2010, the Insurance Council commissioned a further study by Inside Story on how consumers use PDSs[9]. The study found that the PDS did not rank highly with participants as a source of important information that a consumer would use to choose a company. For home insurance products, participants ranked the following sources of information as important:

- my previous experience with the company (59%);
- information on their website about their insurance products (58%);
- insurance product comparison websites (46%);
- recommendations from family and friends (42%);
- information I receive over the phone when I call a company with questions (41%);
- PDS (33%);
- information I have read about them in the newspaper/heard on the radio (19%); and
- other (1%).

The results were similar for car insurance products.

The research also found that only half of participants referred to the PDS when purchasing insurance, with 49% of respondents indicating they did not refer to the PDS before taking out a policy. Of those who did refer to the PDS prior to taking out a policy, only 19% indicated that they read most or all of the PDS. The majority of participants went straight to the sections they were interested in to read in detail or merely “flicked” through the majority of the PDS.

While more participants referred to the PDS following the purchase of a policy (68%), only 15% of these participants read most or all of the PDS. Again, the majority of participants only read sections in detail or flicked though the majority of the document. While PDSs are seen as relevant, comprehensive guides they are not perceived to be very useful documents. Consumers typically keep and file their PDS in case they need to make a claim.

[9] Inside Story (October 2010), *Consumer Insurance Product Information Needs*, Phase 2 Quantitative Report for the Insurance Council of Australia.

A material number of participants (26%) indicated that they found the PDS for home building/contents insurance "very difficult" or "somewhat difficult" to understand (21% for car insurance). Those who found their PDS difficult to read cited the following reasons:

- too detailed and excessive information;
- conditions/fine print was confusing and complicated; and
- information not clear or understandable

Importantly, the research sought participant feedback on four different variations to the existing PDS. The feedback indicated significant differences in preferences between younger and older participants. Those under 40 years prefer a short online form of the PDS with linked references. Those 40 years and older want a simple summary to help them understand different insurance covers and compare between competitors as well as the full PDS to look up specific details and use as a future reference.

The research concluded that there is no simple information solution that is likely to meet every consumer's needs. On balance, the ideal insurance product information solution would comprise a single document containing an upfront plain English summary with hyperlinks/references to the detailed information located in the back section of the PDS. Ideally, the document would work online with hyperlinks and in hard copy format with page references.

5.1.3. Susan Bell Research

In 2013-14, ASIC commissioned Susan Bell Research to conduct a study into consumer experiences with purchasing home building and contents insurance, including the use of insurer disclosure material[10]. The quantitative component of the research found that 2 in every 10 (20%) consumers who took out a new policy or considered switching their policy said that they read the PDS, which is significantly lower than the 51% finding in the Inside Story research[11]. Other research commissioned by the Insurance Council found that for home insurance and motor insurance products, 51% and 37% of respondents respectively had read the policy documents[12].

The research suggested that making a decision without the PDS was the option most consumers defaulted to. Feedback from some consumers suggested that they received the PDS at a stage of their purchase process whereby they were already emotionally committed to a product and did not want to expend further time and effort to read the PDS.

The research suggested that consumers generally had limited motivation to seek information proactively because of some incorrect assumptions about insurance, including:

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[10] Susan Bell Research (October 2014), *Insuring your home: Consumers' experiences buying home insurance*, ASIC Report 416.
[11] While the sample size of both research is comparable (1058 participants in the Susan Bell research and 807 in the Inside Story research), the question asked differed (respondents were asked whether they "read" the PDS in the Susan Bell research whereas respondents were asked whether they "referred" to the PDS in the Inside Story research).
[12] Quantum Market Research (2014), *Understand Home Insurance Research Report*, prepared for the Insurance Council of Australia; and Quantum Market Research (2014), *Understand Insurance Motor Research Report*, prepared for the Insurance Council of Australia.

- all policies are the same;
- "cover" is absolute;
- it is unnecessary to plan for an event which seems unlikely;
- exclusions are the only aspect of cover that they should consider; and
- a consumer can judge the risk of a natural disaster affecting them, and the extent of the potential damage.

The research also found that some consumers took a shortcut through product complexity by making decisions only on price and brand familiarity. The report states:

> "Consumers use price as a cognitive frame which influences the way they conceptualise their search, in turn limiting the information they seek from insurers and the criteria they use to evaluate their quotes."

The research also found that knowledge about insurance is more likely to be obtained from personal experiences, including making a claim; knowing someone who had made a claim; living in a higher risk areas; or by making phone enquiries with insurers. The report states:

> "Lack of context makes it difficult for consumers trying to understand the information provided by insurers. Consumers are effectively expected to understand the likely future implications of the presence or absence of listed policy features. These features really only become meaningful when the event has occurred."

The research found that the language of home insurance can be complex and unhelpful; for example, many consumers were confused about the distinction between total replacement policies and sum insured policies. Some consumers with sum insured policies assumed that their policy would "totally replace" their home if it was destroyed. The report suggests standardisation of language used across the industry, for example around the level of cover provided, to better enable consumers to compare products.

The report also suggests that consumers need to better understand key risks that may apply to them; however, the disclosure regime prioritises product information over risk assessment.

5.2. CONSUMER UNDERSTANDING OF GENERAL INSURANCE

The effectiveness of disclosure is often gauged by reference to consumer knowledge and understanding about key product features. While not a direct measurement of the effectiveness of disclosure, significant gaps in consumer knowledge may signal areas where disclosure has not been useful.

While consumers generally report relatively high levels of understanding about general insurance[13] and in comparison to other financial topics[14], knowledge appears to be less comprehensive when consumers are prompted about specific aspects of insurance policies.

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[13] Research commissioned by the Insurance Council in 2010 confirmed relatively high levels of self-reported understanding about insurance, with 82% and 78% of respondents indicating they have a good/very good understanding of car and home building/contents insurance respectively.
[14] ASIC (March 2011), *Financial literacy and behavioural change*, Report 230.

Research commissioned by ASIC into consumer understanding of home insurance suggests that consumers generally know very little about home insurance, with many assuming that all policies are the same[15]. Knowledge appears to be weighted towards flood and fire exclusions, and specific features more closely reviewed due to the experience of previous claims. Recent research commissioned by the Insurance Council found that many consumers overlook important criteria when selecting their home insurance policy; 44% of homeowners did not consider the excess and 47% did not consider policy exclusions when selecting insurance cover[16]. Another area commonly subject to consumer mistakes is the level of insurance cover, with many consumers being underinsured unknowingly rather than deliberately[17]. The latest ANZ financial literacy survey[18] confirmed that the level of cover does not appear to be taken into account by many consumers when arranging a new policy, with 45% of respondents suggesting that the level of cover is a factor taken into consideration.

The ANZ financial literacy survey also suggests that more work needs to be done in raising awareness about consumer rights and responsibilities in relation to insurance. Despite the long-standing duty of disclosure obligation, and its constant disclosure, 58% of respondents to the survey were not aware that a claim could be refused if the policyholder had not given accurate answers. In contrast, 73% of respondents were aware of the ‘cooling off’ period for those taking out a new insurance policy.

Feedback from insurers also suggests a significant knowledge gap amongst consumers in relation to CTP insurance, which is interesting given the standardised nature of the product. A survey commissioned by Suncorp showed a high level of misunderstanding about the coverage provided by CTP insurance; with 40% of respondents incorrectly indicating that CTP provides cover for repairing vehicles, damage to road infrastructure or damage to other property[19].

Of concern, field research into customer attitudes conducted by IAG[20] suggests that not understanding insurance seems to be socially acceptable. Interestingly, the research indicates knowledge does not appear to correlate with level of education; consumers from diverse socio-economic backgrounds show similar shortcomings in knowledge about insurance. Whilst other equally complex financial concepts, such as interest rates, are generally well understood, knowledge of basic insurance concepts seems to be much poorer.

It was put to the Taskforce that the banking sector is much more advanced in their financial literacy and customer engagement programs. In contrast, unless a claim needs to be made, insurers have traditionally only had contact when a policy was taken out or renewed. However, there are strong arguments to suggest this strategy is not leading to positive outcomes.

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[15] Susan Bell Research (October 2014), *Insuring your home: Consumers’ experiences buying home insurance*, ASIC Report 416.
[16] Quantum Market Research (2014), *Understand Home Insurance Research Report*, prepared for the Insurance Council of Australia.
[17] Finding from field research conducted by IAG.
[18] ANZ and The Social Research Centre (May 2015), *ANZ Survey of Adult Financial Literacy in Australia*, pp. 88-89.
[19] Newspoll Market & Social Research (May 2011), *CTP Insurance Study*, commissioned by Suncorp.
[20] Over the past 2 years, IAG has conducted ethnographic research to better understand how customers make decisions in relation to their insurance needs.

While the complaints data collected by the Financial Ombudsman Service (FOS) is not granular enough to capture insights into issues that may be generated by deficient disclosure, FOS has observed that around 50% of complaints it receives is attributable to consumers asserting a misunderstanding the coverage provided by their policy.

5.3. OTHER RESEARCH

5.3.1. Australian Research

There have been few other empirical studies into the actual uses of PDSs, or other disclosure documents, by consumers in Australia. The most comprehensive experimental research into the form and substance of disclosure that consumers are most responsive to is the O'Shea's study into short form disclosure for consumer credit products[21]. The final report was released for consultation by the Government in 2011, and was instrumental in the development of KFS disclosure for home loans and credit card products. This study did not include testing of short form disclosure for home insurance.

The objective of the study was to develop pre-contractual consumer credit disclosure that is meaningful to consumers in making informed purchase choices. The study utilised a three-dimensional model of comprehension testing, focus groups and cognitive interviews to test the effectiveness of different forms of long and short-form disclosure for home loans, credit cards, car loans and store cards.

While the O'Shea study found that comprehensive and detailed pre-contractual disclosure is not effective, it concluded that mandatory pre-contractual disclosure should not be abandoned. Rather, pre-contractual disclosure should be streamlined and targeted at the information required by consumers to make informed choices. Disclosure needs to be in clean, self-explanatory formats which are less text-based than conventional legal documents.

Importantly, the O'Shea study showed that even for similar products, consumer reactions to short form disclosure varied significantly; with short form disclosure being more effective for home loan and credit card products than car loan products. The study also showed that the timing of disclosure matters, with consumers given exposure to early disclosure having better comprehension of products and higher confidence levels. The report suggests that opportunities for earlier disclosure should be explored; within the context of consumer credit products, examples include disclosure through pre-approval or solicitation letters, advertisements and the application process.

Research commissioned by the Investment and Financial Services Association (now the Financial Services Council) into the information needs of superannuation investors is also noteworthy[22]. The research found that the role of the PDS is confused, with participants variously seeing it as a selling tool, an education tool, or a reference document. PDSs were described by respondents as disengaging and difficult to understand. However, on re-

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[21] O'Shea, P. (2010), *Simplification of Disclosure Regulation for the Consumer Credit Code: Empirical Research and Redesign – Final Report*, Prepared for Standing Committee of Officials of Consumer Affairs, UniQuest Project No. 14808.

[22] Wallis Consulting Group (March 2008), *Report of Findings of Qualitative Research into Effective Disclosure (Stage II)*, report for Investment & Financial Services Association.

reading their PDS, many actually found it was not as difficult to understand as they had originally thought. Rather the length, the appearance of difficult language and terminology, and the format of some PDSs had originally deterred some people from reading and trying to understand the document. Most respondents considered the ideal length of PDSs to be 15 – 20 pages long.

Consistent with the Inside Story research, this study suggested that consumer experiences of the PDS document varies significantly from respondent to respondent, depending on factors including pre-existing knowledge and experience, the level of importance they placed on superannuation, any assistance/advice received as well as the individual PDS itself.

5.3.2. International Research

A comprehensive literature review by the UK Financial Services Authority (now the Financial Conduct Authority) confirms that there is limited international research into the effectiveness of disclosure specific to the insurance sector[23]. The only insurance-specific research is the de Meza (et al) experimental study into the impact of certain disclosures on consumers' decision to purchase payment protection insurance (PPI) in the UK.

The key finding from this study is that disclosure of conflicts of interest and information on payout ratios has no impact on consumer behaviour in face-to-face insurance selling. It is suggested that this is largely attributable to the role of trust in influencing decision-making; demand for insurance increases for buyers with a more trusting nature (regardless of the disclosures made). However, contrary to expectations, disclosure of a conflict of interest often enhanced the credibility of the seller in the experiment.

On the other hand, there has been considerable research done into the effectiveness of disclosure for banking and investment financial products. The UK FCA has led work on consumer testing of different forms of disclosure, with noteworthy examples including studies into:

- the effectiveness of text alerts and mobile apps for banking products – finding that text alerts and mobile banking apps reduces the amount of unarranged overdraft charges by up to 24%[24];
- the impact of the timing of disclosure on consumer behaviour[25]; and
- the significant impact that small changes to information presentation can have on consumer behaviour[26].

From the literature available, the FCA concludes that consumers may not be able to fully understand relevant information or use it correctly at the time of making a decision. However, there is scope for mandated disclosure to benefit consumers if information is

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[23] Oxera (2012), *Review of literature on regulatory services*, Report to the Financial Services Authority, September.
[24] Financial Conduct Authority (2015), *Message received? The impact of annual summaries, text alerts and mobile apps on consumer banking behaviour*, Occasional Paper No.10.
[25] Financial Conduct Authority (2015), *Stimulating interest: Reminding savers to act when rates decrease*, Occasional Paper No. 7.
[26] Financial Conduct Authority (2013), *Encouraging consumers to claim redress: Evidence from a field trial*, Occasional Paper No. 2.

disclosed in an appropriate manner and format so that it becomes "embedded" in a consumer's decision-making[27]. Weil (et al)[28] suggests that in order for information to become embedded, the consumer needs to perceive the information as valuable in achieving their goals; information is compatible with decision-making routines; and it is comprehensible. Empirical studies suggest that disclosure of simple information can enhance transparency, however, the effectiveness of disclosure of more complex information is limited. Further, mandating additional disclosure (that is ineffective) can cause more harm than good.

While some general principles on effective disclosure can be drawn from the empirical studies completed to date[29], the increasing influence of behavioural sciences has given greater credence to the view that the impact of disclosure cannot always be accurately predicted and each case needs to be assessed individually.

5.4. LIMITATIONS AND GAPS IN RESEARCH

Most of the research reviewed relies either on consumers stating their views or self-reporting knowledge/use of disclosure. This research methodology is inherently flawed, as consumers are prone to over-confidence and may rate their own knowledge as higher than it actually is. This may explain the divergence of overall high rates of self-reported knowledge and the low levels of knowledge about key insurance concepts (for example, CTP insurance). Similarly, surveying views about disclosure may generate findings that do not correlate to how consumers actually use disclosure documents. For example, a respondent to the survey of Suncorp customers' awareness and usage of the KFS conducted for the Taskforce indicated that they did not read the KFS as they had read the previous year's (the KFS was only introduced less than 12 months ago).

The Taskforce considers that other data that would generate observable facts about how consumers actually use disclosure would be preferable to self-reported data; for example the proportion of customers that download the PDS online before a policy is purchased. Insurers' day-to-day interactions with customers shows a growing shift towards the use of insurer websites, social media, web chat and videos in seeking information. The data generated by these activities holds a potential wealth of information about what consumers are looking at and how they engage with this information.

Another challenge in measuring the effectiveness of disclosure is the lack of empirical evidence around how consumers actually make decisions[30]. Much of the research that has been done relies on some form of comprehension testing; for example, research respondents are asked to review a disclosure document and then tested on their comprehension of the disclosure.

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[27] Oxera (2012), *Review of literature on regulatory services*, Report to the Financial Services Authority, September.

[28] Weil, D., Fung, A., Graham, M. & Fagotto, E. (2006), "The Effectiveness of Regulatory Disclosure Policies", *Journal of Policy Analysis and Management*, 25(1): pp. 155 – 181.

[29] Hogarth and Merry provide some general observations on good disclosure principles from the consumer testing work by the US Federal Reserve Bulletin into banking products [Hogarth, J. M. & Merry, E. A. (2011), "Designing Disclosure to Inform Consumer Financial Decision-making: Lessons Learned from Consumer Testing", *Federal Reserve Bulletin*, August, 97(3)]

[30] Gillis, T. B. (August 2015), *Putting Disclosure to the Test: Toward Better Evidence-based Policy*, Harvard University.

However, this is merely testing the respondent's comprehension of disclosure and not the actual effect of disclosure on decision-making; it is assumed that improved comprehension leads to better decisions. Experimental settings are also limited in providing insights into the real-life impacts of disclosure; for example, an individual's reaction to a disclosure document in a lab setting may be very different to how that same individual would receive disclosures in real-life impacted by every-day distractions. These are the key challenges in measuring actual consumer behaviour and the implications this has for disclosure.

Having reviewed the literature available, the Taskforce considers that there is a significant gap in understanding about how consumers actually use general insurance disclosure, and how disclosure impacts decision-making. The lack of empirical research has been a significant barrier to the Taskforce being able to reach firm conclusions about the effectiveness of disclosure for the general insurance consumer. As such, the Taskforce recommends further research as a high priority. The design of research should take into consideration the limitations of methodologies that rely purely on consumer self-reporting or which focus purely on consumer comprehension.

In order to establish a benchmark to evaluate the effectiveness of future initiatives to improve disclosure, current consumer knowledge and understanding of commonly purchased insurance products should be measured. This measurement should be undertaken on a periodic basis to ensure a consistent database on consumer knowledge and understanding of general insurance concepts and products are established and maintained.

In order to measure the success or failure of any changes, this benchmarking exercise will be crucial. One of the biggest weaknesses of the current research is that there is virtually no understanding of what the actual impact on consumers is. To ensure that future reforms have positive impacts, it will be necessary to test their impacts on consumers before implementing them. Failure to do so could potentially see industry incur significant cost to implement reforms that are ineffective – or worse, actively harmful to consumers.

The Taskforce is aware of research recently commissioned by the Financial Rights Legal Centre which may investigate questions around the effectiveness of pre-contractual disclosure. The Insurance Council should ensure any research it commissions complements this research.

Recommendation 1: The Insurance Council should establish a disclosure performance benchmark by commissioning and publishing research on current consumer knowledge and understanding of commonly purchased general insurance. The research should be based on observations of actual behaviour rather than consumer self-reporting, and be used to measure the effectiveness of future initiatives.

Recommendation 2: The Insurance Council should commission and publish research to determine pre-purchase consumer behaviours and how disclosure can be used to nudge appropriate decision-making. This research should be based on observations of actual behaviour rather than consumer self-reporting.

As with all of the research-focused recommendations in this Report, the Taskforce is of the view that involvement of a range of stakeholders is essential in producing research that is credible. Research should be designed by an advisory group involving insurers and consumer advocates. The same advisory group should comment on draft reports prepared by researchers.

INSURANCE COUNCIL OF AUSTRALIA

6. The Role of Disclosure: Challenges and Opportunities

The primary objective of disclosure should be to help consumers purchase a general insurance policy appropriate to their needs. The industry should be conscious of the challenges in achieving this objective, including:

- consumer distrust of insurers;
- the length and complexity of disclosures (including the complexity of insurance policies themselves);
- the difficulty for consumers in making product comparisons;
- information gaps;
- consumer behavioural biases; and
- low levels of financial literacy

There is a need to ensure that disclosure and ancillary guidance addresses these challenges and actually assists consumers in assessing the suitability of a product against their needs.

The Taskforce observed a distinction between mandated disclosure and effective disclosure. Mandated disclosure sets the minimum benchmark required by law. However, effective disclosure cannot be achieved simply by reference to the minimum legal requirements. Effective disclosure needs to be informed by the core concept of transparency; the availability of information that encourages effective decision-making.

6.1. THE MULTIFACETED ROLE OF DISCLOSURE

The stated objective of disclosure in the Corporations Act is to provide information that "…a person would reasonably require for the purpose of making a decision, as a retail client, whether to acquire the financial product". In its guidance, ASIC broadens this objective by stating that the PDS should help consumers compare and make informed choices about financial products[31]. Hence, the objective of mandated disclosure is not just to provide product information, but assist consumers in making choices about their insurance purchases.

However, as acknowledged by the FSI[32], disclosure serves a range of purposes in practice. Disclosure is used by intermediaries to help them understand the detailed features of a product and assess its suitability for particular clients and enable comparison between products. For insurers, disclosure is used to define the product and to set out the legal terms and conditions to provide contractual certainty. Within this context, it is possible to develop a very simple PDS that contains limited terms and conditions (including the policy exclusions). However, the policy will cost more (and perhaps much more) if the insurer is not able to exclude unacceptable items of property or types of risk.

Ultimately, disclosure is used as the primary tool to breach the gap between a consumer's expectations about the policy and what is actually covered. Consumer misunderstanding

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[31] ASIC (September 2010), *Disclosure: Product Disclosure Statements (and other disclosure obligations)*, Regulatory Guide 168.
[32] Financial System Inquiry (July 2014), Interim Report, p. 3-55.

about policy coverage could cause severe financial loss for the consumer as well as significant reputational damage to an insurer. An expectations gap that is consistently recurring, such as can be observed in underinsurance, has wide ramifications for the industry, consumers and the community.

The industry is also increasingly recognising the importance of effective communications in strengthening customer relationships and as a strategic imperative for long term market success. Research confirms the importance of user-friendly and clear communication in the longevity of an insurer's relationship with a customer[33]. From this perspective, innovative disclosure is used by some insurers as a point of product differentiation.

While disclosure currently serves a range of purposes, the Taskforce considers that the primary objective of disclosure should be to help consumers purchase a general insurance policy appropriate to their needs.

6.2. CHALLENGES IN DISCLOSING EFFECTIVELY

There are a number of challenges in ensuring that disclosure is effective in assisting consumers to make appropriate insurance choices.

6.2.1. A Trust Deficit

Consumer disengagement is a significant barrier to effective disclosure. A global insurance consumer survey found the trust deficit in the insurance industry is significant when compared with other industries. Only 53% of Australian respondents cited "complete" and "moderate" trust in insurers, compared to 78% for supermarkets and 71% for banks[34]. Currently consumers associate disclosure with the insurance industry protecting itself. As a consequence, consumers have become disengaged as they perceive no benefit in attempting to understand the information provided by insurers.

The tendency for some insurance brands to market their products by reference to the ease and limited time required to make a purchase may have reinforced consumer preferences for limited engagement at the point of sale.

Field research conducted by IAG into customer attitudes and behaviours suggests that consumers are much more engaged in making decisions about their financial needs (including mortgages, superannuation and health insurance) other than general insurance. This seems to stem from a perception that there is no benefit in engaging, framed by an assumption that the insurer will always "win".

Over the past few years, the regulatory regime has attempted to address any identified gap in consumer knowledge by requiring the provision of more information at the point of sale, for example, the provision of additional disclosure through the KFS. However, insurers suggest that they have reached the limits of consumers' willingness to receive and provide information during the sales process. To some extent, the lack of previous claims

[33] Ernst & Young (2014), *Reimagining customer relationships*, Global consumer insurance survey report. 43% of consumers surveyed indicated that easy to understand and clear communications is one of the most important characteristics during an ongoing relationship with their general insurer.
[34] Ernst & Young (2014), Reimagining customer relationships, Global consumer insurance survey report.

experience may have a bearing on the motivation of a consumer to engage with disclosure. As most consumers have not experienced a claim, there is a lack of context to frame the disclosure and provide the motivation to be engaged.

6.2.2. Length and Complexity

The most often cited problem with mandated disclosure documents is their length and complexity. Research has suggested that retail consumers are not likely to read documents that are more than 2-3 pages in length[35]. A range of studies have shown a decline in decision quality when consumers are provided with information beyond a certain level. The studies show that decision-making is most effective when consumers are presented with more than 5 but fewer than 10 attributes for each product choice[36].

The mandated disclosure regime encourages licensees to take a risk-averse approach to compliance, rather than providing disclosure material that is focused on informing consumers[37]. Insurers have had a tendency to take a conservative approach to regulation, which has resulted in the oversupply of information in PDSs.

An additional issue for general insurance disclosure is that the PDS is also used to satisfy the “clearly inform” consumer test under the Standard Cover provisions in section 35 of the Insurance Contracts Act. Section 35 states that if an insurer seeks to limit or exclude its liability in respect of the standard cover, then the insurer must prove that it clearly informed the consumer of the limitation or exclusion. Court decisions considering what “clearly inform” means encourages disclosure in PDSs as a means of satisfying the requirements of section 35.

A study into the barriers to more effective drafting of PDSs in the superannuation and managed investment scheme sectors had the following findings[38]:

- product issuer risk aversion – the benefits of producing user-friendly documents are outweighed by the costs of not complying with the legislation or having to defend such charges;
- principles-based legislation – it is unclear how issuers can achieve ‘clear, concise and effective’ disclosure in practice;
- complexity of disclosure-related legislation – disclosure requirements are not only contained in the Corporations Act;
- problems with the Incorporation by Reference (IBR) provisions – there is uncertainty around when and how IBR can be used; and

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35 Committee for European Securities Regulators (CESR) (July 2009), *CESR’s Technical Advice to the European Commission on the Format and Content of Key Information Document Disclosures for UCITS*, Consultation Paper.
36 Paredes, T. A. (2003), *Blinded by the Light: Information Overload and its Consequences for Securities Regulation*, Washington University Law Quarterly, June 2003.
37 Parliamentary Joint Committee on Corporations and Financial Services (November 2009), *Inquiry into financial products and services in Australia* (Rippoll Inquiry).
38 Access Economics (December 2008), *Factors Affecting the Drafting of Product Disclosure Statements*, report for the Treasury.

- the many parties involved in PDS development within an organisation often results in lengthier documents.

Research has also found that complex terminology can be a significant barrier to reading a PDS; more so than the document length[39]. In the general insurance sector, it has often been suggested that complexity is difficult to avoid, as even simple terms like "flood" can have technical and complicated definitions. Stakeholders such as the Victorian FSL Monitor have also suggested that even commonly used terminology such as "no claims bonuses" and "loyalty discounts" cannot easily be verified from the text of the PDS and requires more transparent disclosure[40].

Complexity is not limited to the content of disclosure, but also the process in accessing the correct version of the document. Due to the costs associated with maintaining printed PDSs, changes to terms are disclosed by way of a Supplementary PDS (SPDS). The availability of different versions of a PDS and SPDS applying to a policy purchased during specific time periods increases search costs and decreases the accessibility and comprehensibility of disclosure. Learnings from behavioural sciences suggest that even very small friction costs can have a disproportionate effect on consumer behaviour.

6.2.3. Difficulty in Making Product Comparisons

A 2009 study commissioned by the Insurance Council found that PDSs in the general insurance industry do not facilitate product comparison.[41] Barriers faced by consumers attempting to compare products include variations in the:

- terminology and definitions used;
- presentation of inclusions and exclusions;
- packaging of policy documents (e.g. PDSs vary in whether home and contents policies are within the 1 or 2 documents);
- style of presentation; and
- the structure of cover (e.g. how the events are organised).

The ineffectiveness of disclosure in facilitating product comparison is a key driver in the growth of comparison websites. Some commentators, including the Victorian FSL Monitor, have suggested the development of price comparison aggregators for general insurance products should be encouraged. However, an ACCC report on the comparator website industry in Australia found that the simplification of information on these websites can decrease the transparency of important differences between products and policies[42]. The findings from a UK FCA review into Price Comparison Websites (PCWs) in the insurance sector also found the simplification of products on PCWs fuelled perceptions that all products are the same and discouraged consumers from obtaining knowledge on products.

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[39] ASIC (March 2011), *Financial literacy and behavioural change*, Report 230, p. 38.
[40] Victorian FSL Monitor (July 2014), *Enhancing the consumer experience of home insurance – shining a light into the black box*, Discussion Paper.
[41] The Allen Consulting Group (June 2009), *A better Product Disclosure Statement Regime. A roadmap for improvement*, report to the Insurance Council of Australia.
[42] ACCC (November 2014), *The Comparator Website Industry in Australia*.

Taskforce members had differing views on the potential for comparison websites to improve consumer outcomes.

6.2.4. Information Gap

A range of recent public reports have suggested that disclosures, primarily related to home insurance products, are inadequate in facilitating appropriate consumer decision-making. These identified information gaps are not about product disclosure itself, but related factors required by the consumer to make insurance decisions.

In ASIC's recent report into its review of home insurance[43], the regulator suggests that there is insufficient guidance provided by insurers to assist consumers in calculating an appropriate sum insured amount for home building insurance. ASIC is concerned that, without this guidance, consumers are selecting inappropriate insurance coverage resulting in underinsurance. ASIC acknowledges that most insurers have made available online calculators to assist consumers. However, ASIC found instances where insurers were not referring to their online calculators when communicating with consumers over the telephone.

There have also been suggestions that insurers should do more to disclose their assessment of risks specific to individual consumers. It has been observed that the risk rating process for each consumer is non-transparent, and there are no opportunities for a consumer to challenge particular facts where they are in a better position to assess certain risks. The Victorian FSL Monitor and the Productivity Commission (in its report into Natural Disaster Funding Arrangements) call for greater disclosure by insurers of risks facing consumers.

6.2.5. Impact of Behavioural Biases

Under the disclosure regime, it is assumed that the provision of information will lead to better consumer choices. However, the link between comprehension of information and appropriate decision-making has never been established by empirical research.

The growing field of behavioural economics is increasingly challenging traditional views about the role and effectiveness of disclosure. Studies suggest that people do not make decisions based on the information disclosed. Rather, decisions are based on biases and short cuts. The UK FCA has led work on considering the impact of behavioural economics findings for the regulation of financial products and services[44]. ASIC is also increasingly turning its attention to how consumers can be appropriately "nudged" in making appropriate financial decisions[45].

Some respondents to the FSI concluded that the prevailing regulatory philosophy, that market intervention is warranted only to correct information asymmetries between product providers and consumers, needs to be re-thought. It is argued that too much weight has been put on the role of disclosure when deficiencies in decision-making go beyond apathy or

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[43] ASIC (October 2014), *Review of the sale of home insurance*, Report 415.
[44] Financial Conduct Authority (April 2013), *Applying Behavioural Economics at the Financial Conduct Authority*, Occasional Paper No. 1.
[45] ASIC (March 2015), *ASIC increasing use of behavioural economics across its regulatory business*, Media Release 15-059.

information-based market failure[46]. Central to this argument is that even effective disclosure will have its limitations.

6.2.6. Low Levels of Financial Literacy

Low levels of financial literacy continues to be a significant barrier to consumers being able to understand disclosure. The report has already discussed existing research on consumer understanding of general insurance (at 5.2) and the areas where there appears to significant gaps in knowledge. While the research on the effectiveness of financial literacy campaigns and programs has been inconclusive[47], the general insurance industry's efforts in this space have been relatively new and remain untested.

The Taskforce is of the view that financial literacy work remains essential, and the industry should be encouraged to continue to develop initiatives in this area. However, the focus of this Report is on engagement with consumers at and around the decision-making point where information is most likely to be influential in producing appropriate outcomes.

6.3. THE FUTURE OF DISCLOSURE: WHAT BEST PRACTICE LOOKS LIKE

The Taskforce considers that a major shortcoming in the disclosure regime to date has been its sole focus on information provision without the necessary regard for the consumer's ability to make use of that information.

Field research conducted by IAG into customer attitudes found that mandated disclosure has had little impact on customer understanding because these documents do not address the key barrier to understanding; customer disengagement. A single-minded focus on providing information, without regard to whether it is transparent, relevant or helpful is likely to have exacerbated consumer disengagement and the likely effectiveness of disclosure itself.

There is a distinction between mandated disclosure and effective disclosure. Mandated disclosure sets the minimum benchmark required by law. However, the Taskforce considers that effective disclosure cannot be achieved simply by reference to the minimum legal requirements. It needs to be transparent; that is the information provided should lead to effective decision-making. This differs from an approach to disclosure where information overload encourages passivity. A key test for the effectiveness of disclosure is whether the information provided allows or encourages the consumer to take a course of action.

Some may argue that transparency is an ethical obligation rather than a legal one. In contrast, the Taskforce sees transparency as a logical development of the concept of utmost good faith. There should be an emphasis on producing positive consumer outcomes above and beyond the prescriptive requirements of the mandated disclosure regime.

Transparency is a function of more than just content. Effectively engaging consumers requires consideration of content, context, medium and purpose. The Taskforce considers that transparent disclosure comprises:

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[46] Kingsford-Smith, Dimity (2014), *Focusing on the Interest of the 'Financial Citizen' as Retail Investor and Financial Consumer*, Submission to FSI.
[47] ASIC (March 2011), Financial literacy and behavioural change, Report 230.

- **Information that is clear in purpose** – The design of the disclosure is mindful of the customer life-cycle.
- **Information that promotes consumer engagement** – Consumers want to use the disclosed information because it will make a difference to them. The disclosure is 'action' oriented.
- **Information that encourages informed decision-making –** Information which helps consumers assess the risks they want covered and the level of the cover they want.
- **Information that is targeted and timely** – Information that is immediate to the decision-making needs of the individual consumer at a particular point in time.
- **Information that is contextual –** Any disclosure of risks to consumers needs to be salient; they need to be specific and relevant to the consumer. Examples need to be concrete. Consumers are unlikely to engage with generic risk information in a useful way.
- **Information that is accessible** – Information that consumers can easily locate and prompts that reduce the friction costs of accessing the information. Information that is understood intuitively and is easily transferrable/sharable.
- **Information that is balanced** – Disclosure should be balanced in presenting the benefits and risks of the product.

A challenge for insurers is to ensure that there is a strong element of customer engagement when disclosure documents are developed. Effective disclosure is more likely to be achieved through ensuring that it is subject to input from the whole of the organisation, including customer facing personnel, rather than just the legal and compliance function.

Importantly, considering how disclosure can be made more effective requires thinking, not just about the provision of information, but about the implications of how a product is designed and sold. The more opaque the terms and conditions are, the more likely that disclosure will be ineffective in contributing to consumer understanding.

Insurers have an opportunity to build consumer trust by harnessing emerging technologies and the growing body of behavioural research now available to improve the way they communicate with customers.

Recommendation 3: The industry should shift from a minimum mandated disclosure approach to best practice transparency to better assist consumers to choose a product that meets their needs. Research to be commissioned by the Insurance Council should inform insurer trialling of new and innovative disclosure tools and techniques.

Most general insurers are signatories to the General Insurance Code of Practice (the Code), which includes objectives of promoting "better, more informed relations" between insurers and their customers and maintaining and promoting "trust and confidence in the general insurance industry".

The Taskforce considers that it would be useful for the Insurance Council to issue guidance under Section 11 of the Code on how disclosure practices can help to fulfil these objectives.

The Code Governance Committee can utilise the guidance to monitor industry progress in improving disclosure through its annual reporting.

Recommendation 4: The Insurance Council should consolidate the insights from research to be commissioned to develop guidance under the General Insurance Code of Practice on the principles of transparency in fulfilling the Code's objectives around "more informed relations" between insurers and their customers and promoting "trust and confidence" in the industry.

7. Home Insurance Disclosure and Underinsurance

The Taskforce was asked, as its first priority, to address the FSI recommendation to improve guidance (including tools and calculators) and disclosure for general insurance, especially in relation to home insurance. The Taskforce also considered the related recommendation of the Productivity Commission for insurers to provide additional standardised natural hazard risk information to households.

The Taskforce agrees that insurers should provide guidance to consumers on selecting an appropriate sum insured. At a minimum, the industry should ensure that sum insured calculators are integrated into the sales process for home building so that consumers are given free and automatic guidance prior to selecting their sum insured. The industry should also seek to improve the accuracy of home building and home contents sum insured calculators.

The question of providing consumers with natural hazard information is much more complex. While this information is likely to be beneficial to consumers, its disclosure by insurers may lead to consumers receiving inconsistent and conflicting information from different insurers due to the existence of various data sources. This could cause confusion, rather than be informative.

While the Taskforce agrees with industry's view that the Commonwealth Government has primary responsibility of providing natural hazard information to households, it is understood that the creation of a government portal for hazard data is unlikely to be concluded in the near term. As such, the industry should explore how natural hazard data held by insurers can be effectively provided to consumers.

7.1. GUIDANCE ON SUM INSURED

The FSI, informed by the findings of the ASIC report into the sale of home insurance, made a specific recommendation to improve guidance and disclosure in general insurance (see **Annex 2**)[48]. In its recommendation, the FSI suggests that the industry should guide consumers as to the likely replacement value for home building and contents insurance (reflected in the policy "sum insured"). The report further says, "…if significant progress is not made by industry within a short time frame, Government should consider introducing a regulatory requirement to provide this guidance at the point of renewal or on entering into a contract with a new insurer".

The Taskforce agrees that insurers should provide guidance to consumers on selecting an appropriate sum insured. The consequences of consumers underinsuring by selecting sum insured amounts that are too low have been illustrated in recent natural catastrophes, such as the 2013 Blue Mountains bushfires. Although the ASIC report into the selling of home insurance found instances where insurers were not referring customers to their online calculators over the telephone or through the online quoting system, most insurers already make available sum insured calculator tools. The Insurance Council also has a sum insured calculator available on its "Understand Insurance" website.

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[48] Commonwealth of Australia (November 2014), *Financial System Inquiry*, Final Report.

The Taskforce is aware that several insurers have already made improvements in their sales processes, including the incorporation of calculators into the quotation process. Incorporating a calculator into the quotation process means that consumers do not need to answer the calculator questions separately from the quote, reducing the friction costs in accessing the calculator.

Some insurers have also implemented a sum insured floor that a consumer is allowed to select. For example, Suncorp has established a "minimum sum insured" threshold whereby a customer is unable to select a sum insured that is more than 10 to 15% below the result generated by the calculator. The implementation of the minimum sum insured has resulted in a 15 to 20% uplift to the average sum insured for Suncorp customers. Suncorp advises that establishing a minimum sum insured did not have a substantial impact on customer retention. IAG also has a minimum sum insured threshold of 20%.

The Taskforce considers that these initiatives are a welcome move in the right direction. As a minimum, the Taskforce recommends that sum insured calculators should be integrated into sales processes for home building insurance.

Recommendation 5: Insurers should integrate sum insured calculators into the sales process for home building so that consumers are provided free and automatic guidance prior to selecting their sum insured. Insurers should be able to report substantial progress on this recommendation within 12 months of the release of this Report.

The Taskforce acknowledges that sum insured calculators for contents insurance could also be usefully integrated into the sales process, however, understands that their development has not been as advanced as that for home building insurance. Insurers are encouraged to take steps to improve their calculator tools for estimating required contents coverage. Insurers should also consider the benefits of calculator tools for other general insurance products, such as motor vehicle insurance.

While the provision of accessible sum insured calculators is a good first step, the Taskforce acknowledges that influencing consumers to select an appropriate sum insured amount (which often deviates from calculator results) requires further insights into the drivers of consumer behaviour. Anecdotal feedback received from insurers suggests that some consumers do not use calculator results because they think the calculator is calibrated too highly in order to favour the insurer's commercial interests; that is leading to the purchase of excessive insurance.

The provision of contextual information about the key expenses in a house rebuild at targeted points in the sales process may be useful. For example, providing an itemised list of key expenses that is used to derive the sum insured calculation can prompt consumers to consider the major costs associated with a rebuild and may help counter misperceptions that insurer recommendations about the sum insured is driven by motivations to increase the premium. Contextual information to help consumers understand why certain questions are being asked may also assist consumers in responding in a more informed manner. Examples of possible detriment could help focus consumer attention on the need to give careful thought to setting the sum insured.

Even where consumers use the results generated by calculators, the accuracy of the estimate is dependent on consumers answering the calculator questions with precision. This may not be a simple task where the calculator is seeking detailed information and metrics about the building. A standard form calculator will also have limitations in capturing information about unusual features of a home.

Further research is needed into how to give guidance on home rebuilding costs that consumers will understand, accept, and be able to use to set a sum insured figure. Research into factors such as the terminology used (sum insured and total replacement) and how these terms may contribute to, or hinder, consumer understanding should provide insights into consumers' current experiences in setting a sum insured. The research should also consider the form and content of disclosure that would be most effective in ensuring that consumers understand the risk of calculators not generating fully accurate estimates, as well as the risk of underinsurance where a consumer has purposefully chosen to deviate from the estimate.

Recommendation 6: The Insurance Council should research consumer behaviours in relation to decision-making about the sum insured for home building insurance to inform development, and create ongoing improvement, of sum insured calculators.

Consumers should be encouraged to use calculators, not just for new policies, but for renewing policies as well. Even where automatic indexing increases the sum insured annually for renewing customers, there could still be a significant portion of consumers that are left underinsured if they had originally selected an inappropriate sum insured amount.

For example, in New Zealand some insurers offer incentives for consumers to complete a rebuilding cost calculator. Suncorp advised that its New Zealand business has implemented a combined incentive and marketing campaign offering a free 25% safety net feature in return for completing a rebuilding calculator or obtaining a professional valuation. This approach doubled the number of customers increasing their sum insured proactively outside of renewal and the average sum insured has also increased by 20% per square metre. This incentive approach has motivated engagement in the process and produced a measurable benefit to consumers.

Recommendation 7: Insurers should actively explore the use of incentives to encourage greater use of sum insured calculators in home building and home contents insurance, particularly for renewing customers.

7.2. IMPROVING ACCURACY OF CALCULATORS

The FSI report also recommended that the industry enhance existing tools and calculators for home insurance, including providing up-to-date information about building costs and building code changes. The report says that industry should "standardise" the way replacement costs are estimated, and to the extent that this is limited by the existing regulatory regime, the industry should work with the Government towards a resolution. The varying sum insured estimates that are generated by different insurer calculators has contributed to a perception that these tools are inaccurate and has likely exacerbated consumer mistrust in their results.

Although most insurers use the same source of building cost data for their sum insured calculators, the estimate provided often varies because:

- the number of questions asked about the home ranges between 10 and 40;
- insurers may need to add allowances for costs such as debris or demand surge removal to reflect the design of the particular policy;
- the frequency of updates to data varies (quarterly/annually);
- the cost of rebuild differs from insurer to insurer based on individual arrangements with suppliers; and
- insurers have their own intelligence about the cost of rebuild derived from previous claims costs in the area.

There have been suggestions that the use of a single calculator across the industry will provide greater assurances to consumers that their cost of rebuild is being estimated accurately. While there are industry concerns about the potential need to obtain approval from the ACCC for the adoption of a single standard calculator, the Taskforce does not consider that this presents a significant hurdle. The more serious complication in the adoption of a single calculator is the mismatch that is created between the factors taken into account in the calculator and the design of a particular policy. Debris removal provides a good example. Some calculators are designed to include the cost of debris removal in the sum insured estimate as the policy does not provide separate allowances for these costs. Other calculators do not provision for debris removal because the attached policy has allowed for these costs separate to the sum insured amount.

One standard calculator result across all insurers would therefore also require significant product standardisation of several key features and affect pricing structures.

The Taskforce considers a faster and more cost effective approach will be to for insurers to more actively collaborate on the procurement of calculator data and to conduct research into improving accuracy and better understanding consumer responses to guidance. Placing a greater focus on the calculators at the industry level will help drive improvement in the estimates over time and allow insurers to deliver calculator results in a seamless and automatic way within their respective sales and renewal processes.

This would in effect standardise the inputs to sum insured calculators, without necessarily mandating one end output for consumers and incurring the significant costs of requiring a mandatory restructuring of insurance products. Providing a standard input to insurers will resolve the majority of drivers of different results listed above with the one exception of insurance product related variances. It will therefore become less likely for consumers to receive differing sum insured results and in cases where a variance does arise it will be more clearly attributable to the relevant product rather than the estimate itself.

An option of requiring insurers to separately disclose product related variances in calculator results in the interim period was also considered. However, such an approach risks adding to disclosure complexity and actually undermining trust in the calculator.

As the industry calculator improves and components such as debris removal are built into the industry calculator, the need for insurers to modify the base data to address gaps through product features will reduce. The industry considers that competitive forces would ultimately produce a similar standardisation outcome for consumers.

To increase trust in the sum insured guidance process the industry calculator should also be made available to other trusted bodies such as ASIC's Money Smart, Understand Insurance, Emergency Services and Local Government to enable those organisations interested in addressing underinsurance to also communicate sum insured guidance.

The accuracy of insurer rebuilding estimates is also inhibited by a lack of information about the rebuilding standards applicable in each specific location and the reality that these change over time. For example, where bushfire is a prevalent hazard, the local council may introduce new standards on specific land parcels (when building or rebuilding). This information is neither consolidated by local government bodies nor presented in a uniform fashion. At present, there are 571 local councils across Australia. Consolidating this data into calculators presents a significant and costly challenge. Many property owners themselves report they are unaware of changes to applicable standards.

Many calculators now generate increased sum insured estimates to address additional rebuilding costs that may result from new building standards. However, in the absence of a greater level of coordination between local government bodies in communicating changes to building code standards, the industry will struggle to provide comprehensive information to consumers that is specific to their properties. As technology improves, it will be important for local government bodies to share this type of information so that more accurate estimates can be developed by insurers for provision to consumers through calculators.

Recommendation 8: The Insurance Council and insurers should work with data providers to develop an enhanced sum insured calculator for building insurance that can be used as the industry standard. The Insurance Council should be able to report substantial progress on this recommendation within 12 months of the release of this Report.

7.3. LIMITATIONS OF SUM INSURED POLICIES

Despite industry's best attempts to improve the accuracy of calculators, the Taskforce acknowledges that there are inherent limitations in sum insured policies for total loss scenarios. Particularly in the event of a widespread catastrophic event, consumers potentially face a shortfall in rebuilding costs.

Insurer experience is that the cost of rebuilding will often be inflated following a natural catastrophe event due to the heightened demand for building services. Therefore, while a consumer may be sufficiently insured if their home is destroyed by an isolated event (such as a house fire), the same level of insurance may be insufficient to cover the rebuild costs if their home is lost during a more widespread event (such as a bushfire). As already noted, a margin of error may also exist due to changes in building codes following a catastrophe.

Available research suggests that the majority of consumers are unaware of the potential for out of pocket expenses when they take out a sum insured policy. Misconceptions about the extent of coverage provided are amplified by insurance advertising, which tends to promote broad concepts implying complete cover such as 'peace of mind'.

However, while some risk of underinsurance will always exist for a sum insured policy in relation to natural catastrophes, it should be noted that the Australian market fares comparatively well internationally in terms of the accessibility of broad insurance coverage for natural perils. In other jurisdictions, including Japan and the United States, insurance coverage is not available for all perils.

The Taskforce considered in detail the potential for total replacement (TR) policies, where the total cost of rebuild is covered, to reduce this residual risk of underinsurance. The availability of TR policies internationally and in Australia is limited. Offering a TR policy requires a significant investment in modelling, understanding the customer's property and in portfolio exposure management. Capital requirements stipulated by the Australian Prudential Regulation Authority (APRA) and limited availability of reinsurance makes TR policies a less commercially viable option. The Christchurch earthquakes resulted in the market in New Zealand moving from TR to sum insured policies as the cost of offering TR policies became commercially unfeasible.

The industry anticipates that most consumers, given the choice, would continue to select sum insured policies due to the additional costs of TR policies; TR policies are 15 – 20% more expensive than sum insured policies. The additional costs are attributable to:

- The risk that claims could substantially exceed estimated rebuild costs due to unforeseen effects from a natural catastrophe, for example demand surge.
- The uncapped liability for the insurer. For sum insured policies, the insurer knows the quantum of the maximum claim. For TR policies, the quantum of the maximum claim cannot be determined until a claim is made and, hence, underinsurance risk is transferred from the insured to the insurer.
- Higher rebuild costs. While a defined sum insured provides a target level for rebuild, there is a greater likelihood under TR policies for incremental decisions throughout the rebuild (e.g. low cost tiles vs. high cost tiles) to substantially increase the overall cost of a rebuild.

We acknowledge however that there will be consumers who choose to pay more for the added protection offered by TR policies, and that TR policies may not in all cases be more expensive than sum insured options. The Australian Government's North Queensland home insurance comparator website indicates that the two TR policies on offer, for particular circumstances, are cheaper than other sum insured options.

While the Taskforce was unable to locate any reliable data to substantiate the problem, there is a general understanding that Australian households are substantially underinsured. This is because underinsurance cannot be established until after an insurable event has occurred, as the actual cost of rebuild is dependent on circumstances specific to each event. Many cost factors are also unable to be identified until after a loss has occurred, such as the implications of changes to post-catastrophe building standards and the effects of demand surge. For example, it is estimated that the additional demand on the building industry after Cyclone Larry in 2006 increased building costs by 20 – 50%[49]. Also, actual cases of observed underinsurance are not common, as underinsurance only eventuates in total loss situations.

[49] Olsen & Porter (2010) and Jeyendran (2010)

Available research[50] shows that:

- 71% of home owners believe they are insured for the full cost of rebuilding their home;
- 48% of residents know whether their home is compliant with current home building codes related to bushfire resilience (17% out-right do not know and 18.5% are unsure);
- 17% of Australians have contacted their insurer to update or check on their home and contents insurance, up from 15% in 2014; and
- 16.5% of Australians have specifically checked that their sum insured takes into account any extra rebuilding costs from changes to building codes/standards.

The Taskforce can see the potential benefits to consumers of TR being sold alongside sum insured policies. Greater availability of TR policies would provide consumers with more product choices and could also help to draw out the residual risks inherent to sum insured policies. While particular insurers in particular locations can and do offer TR policies, the industry is of the view that Government mandated TR policies could have serious implications for the economic viability of individual insurers, as well as broader economic impacts if a large scale natural disaster were to occur in Australia.

7.4. NATURAL HAZARD RISK INFORMATION

In its Inquiry into Natural Disaster Funding, the Productivity Commission observed that consumers would benefit from more information about the natural disaster risks they face; how insurance products can assist them manage their risks; and an indication of their residual exposure. The Commission recommended that insurers should provide additional standardised information for households (see **Annex 3**), such as on:

- natural disaster risks in their area;
- indicative rebuilding costs; and
- examples of household-level mitigation options.

Guidance on rebuilding costs have already been addressed in the previous section.

The rationale for the disclosure of natural hazard information is that properly informed households are in a position to make better decisions with regard to purchasing appropriate levels of insurance. Further, this information could enable households to manage hazard impacts before they occur. With increasing industry access to sophisticated risk data, the long held assumption that the insured knows more about their risks than the insurer has given way to a situation where insurers are often more knowledgeable.

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[50] Newspoll conducted an independent internet survey of 3283 Australians, 18 years of age and older in March 2015. Data was collected in line with ISO 20252 – Market, Social and Opinion Research and has been weighted with current ABS population demographics to ensure any extrapolation of results is representative of age, sex and area.

However, the provision of natural hazard data to consumers is complicated by the numerous sources of data. Most of the data for flood, fire, cyclone and earthquake hazards is held by the various levels of government. The Insurance Council has played a role in collecting, centralising, and making this data available to insurers. Individual insurers often combine this common data with their own data for use in underwriting, making it commercially sensitive data. Each source of data, whether it is public or private, will entail different methods for measuring risk and this will result in various sources potentially providing conflicting data in assessing the same risk. Essentially, there is not a single “source of truth” in assessing a consumer’s specific natural hazard risks.

Therefore, while the provision of natural hazard information to consumers is likely to be beneficial, its disclosure by insurers may well lead to consumers receiving inconsistent and conflicting information from different insurers. For example, while one insurer may assess a particular household’s flood risk to be medium, another insurer may have more detailed data from past claims experience and assess this same household as a high flood risk. The provision of inconsistent natural hazard data to consumers will create confusion, rather than be informative.

For this reason, the industry believes that the Commonwealth Government is in the best position, and has a responsibility, to provide natural hazard data to the public. A government portal would be a comprehensive, neutral and authoritative source of information. Importantly, consumers would receive a single source of information about their risks, as opposed to multiple and conflicting sources.

As suggested by the Australian Business Roundtable for Disaster Resilience and Safer Communities (Business Roundtable)[51], a national platform for natural hazard data would improve the quality, availability and accessibility of information in Australia. This would, in turn, create opportunities to convert natural hazard data into useful information that improves the communication of natural hazard risks to better inform decision-making and research in a wide range of areas, including emergency management, land-use planning and insurance. Much of the information needed to address natural hazards understanding is common across many sectors. It is efficient to coordinate the production and dissemination of this information centrally to ensure consistency both in the format and access mechanism of data.

The federal Attorney-General’s Department is currently exploring how best to provide natural hazard information to households. There are considerable governance hurdles that need to be overcome in order for a federal government solution to bear fruit. The Insurance Council’s assessment is that it is unlikely a federal government project will be able to progress to conclusion within the near term. However, State governments are making considerable progress with several having completed community portals for hazard data and others in advanced stages. These initiatives are not tailored well for general consumer use, but do provide a first step. Examples include the Queensland Globe and Open Data VIC.

Recommendation 9: The Insurance Council should continue to press government to make natural hazard information available and accessible via a centralised portal to better inform the community of their risks.

[51] Deloitte Access Economics (June 2013), *Building our Nation’s Resilience to Natural Disasters*, report commissioned by the Australian Business Roundtable for Disaster Resilience.

While a government-led solution would be ideal, the Taskforce considered the role that the industry should play in addressing the information gap.

An insurer's commercial assessment of risk and the reasons for its disclosure differs markedly from the assessment of risk as a public good. The industry had traditionally indicated their assessment of risk to consumers through the price signal. Whether insurers should disclose their commercial assessment of risk hinges on the question of whether consumers need more than just the price to make an informed decision. Taskforce members had widely differing views on this question, and it has not been able to be resolved in the time available.

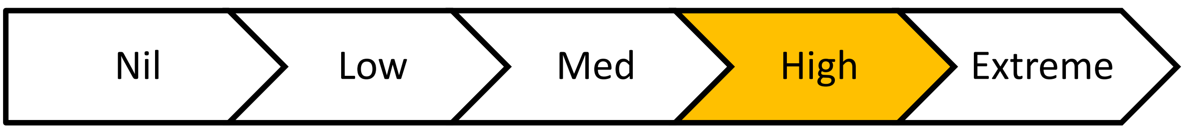
A survey[52] commissioned for the Taskforce suggests that consumers are generally quite positive about receiving information about natural hazards, with around 8 in 10 agreeing it would be useful, improve their understanding of their potential risks and their increased likelihood of a claim. Respondents were also shown an example of a natural hazard risk disclosure (illustrated in **Illustration 1**), provided the following feedback:

- 81% said the disclosure is easy to understand;
- 78% said the disclosure would improve their understanding of their potential risk from a natural hazard based on where they live;
- 77% said the disclosure would be useful to them; and
- 74% said the disclosure would make them aware of the increased likelihood of a claim because of the risk of a natural hazard.

Illustration 1: Example of natural hazard risk disclosure

Your level of risk

We have assessed your flood risk as **high**:



A **high** risk rating means that we estimate you are more likely than an average policyholder to lodge a claim related to flood damage. This is based on what you have told us about your home and the best information currently available to us for your address.

Please note this is our estimate only, it may differ from other insurers and from government estimates. It is also possible that this rating will change in the future as we improve our understanding of risk.

To find out more, visit www.insurer.com.au/riskrating

[52] Vision Critical (September 2015), Survey of Suncorp home building and contents insurance customers. Survey was conducted between 4 – 10 September. Respondents must have renewed or taken out insurance since January 2015. 301 respondents completed the survey. IAG conducted the same survey with its customers that yielded consistent findings.

Those respondents who did not feel the disclosure would be useful (2 in 10) provided a range of reasons; some felt the information would not be useful because:

- they do not perceive any risks where they live;
- some felt they were receiving the information already; and
- others were suspicious of how the rating would be calculated.

Importantly, the survey found that the provision of hazard information is likely to result in substantial further consumer queries; 50% of respondents had questions about the information received. Most focused on how this information would affect premiums, if the hazard risk would be covered and the impact if a claim was made. Many wanted to know how the assessment of risk would be calculated, and if they could receive details of these types of events in their area.

While the survey findings suggests that consumers would be receptive to receiving natural hazard risk information, the Taskforce considers that the specific type of information, how it is disclosed and its likely impact on decision-making needs to be further explored. For example, learnings from behavioural economics indicates that disclosure needs to enable consumer action in order to be effective. There needs to be consideration of how the disclosure of natural hazard information can either facilitate consumer decision-making or other action, for example, risk mitigation.

The Taskforce also acknowledges that natural hazard risk information will be of much greater value to the minority of the population exposed to natural hazard risks; for example, on current data 93% of Australian homes have no flood risk. While consumers facing little or no risk may find value in this information, it is likely that more targeted disclosure of risk to those consumers that are considered to be of higher risk will be more effective.

Insurers also advise that the provision of natural hazard risk information would require additional consideration of the potential legal liability that may arise for insurers.

Whether insurers could provide more of their natural hazard data to consumers was the subject of considerable discussion at the Taskforce meetings. The Taskforce's consumer advocate representative, and other consumer advocates providing feedback to Taskforce, wanted to record their disappointment that insurers cannot currently find a way to release the hazard data they have to consumers.

Although there are a range of significant challenges in disclosing insurer-held risk information to consumers, the Taskforce sees this as an important area requiring progress by insurers. The challenges should not be underestimated and it is important the issue is treated with due consideration.

It is therefore proposed that the Insurance Council should adopt a leadership position and establish a high-level committee consisting of industry, consumer advocate and government representatives with the express purpose of exploring, documenting and overcoming the barriers to risk communication to consumers. The Committee should also consider how to present that information to consumers effectively. This work should be carefully informed by the other disclosure research proposed to ensure information is not merely disclosed, but is structured to encourage effective decision-making.

Recommendation 10: The Insurance Council should establish a committee to determine how natural hazard data held by industry can be effectively provided to consumers in a consistent format to improve their understanding of natural hazard risks specific to their homes. The Insurance Council should be able to report substantial progress on this recommendation within 12 months of the release of this Report.

In relation to the Productivity Commission's suggestion that the KFS should be expanded to include natural hazard information, insurers consider that this document does not easily lend itself to natural hazard risk disclosures that would be useful to consumers. Due to the standardised nature of the document, insurers would only be able to disclose generic risk information. As well, the KFS is highly prescribed and any changes to its content and format would require legislative change.

8. Strategic Opportunities for Improving Disclosure

The current disclosure regime was ushered in through the FSR reforms in 2001, when consumer engagement with insurers was shaped by much more limited information channels. The likelihood of ongoing rapid technological change will mean that this relationship will be subject to continual evolution over the coming years. The Taskforce has identified a number of specific areas where disclosure could be made to be more effective.

The Taskforce considers that there is insufficient evidence to warrant a radically different format for the PDS. However, what appears to be needed at the pre-contractual stage is information/prompts to consider particular issues relevant to a consumer. This could be made available through a variety of channels. Electronic forms of disclosure also have the potential to enable insurers to better target information that is relevant to a consumer.

Insurers should explore and adopt new forms of electronic disclosure that enable information to be delivered in more relevant and personalised ways. This will be facilitated by appropriate law reform to enable electronic communication as the default method of providing insurance product disclosure.

The Taskforce also recommends that a reconsideration of how the financial advice regime applies to the general insurance industry should be undertaken to assist insurers to better engage with consumers. ASIC should provide regulatory guidance, and where necessary relief, to support the provision of advice to consumers purchasing general insurance products.

The Taskforce considers that disclosure should aim to facilitate effective product comparisons by consumers. The industry should conduct a review of product comparability options to identify methods of improving consumer understanding of coverage differences between products.

Effective disclosure is disclosure that is relevant and timely throughout the life of a product and opportunities to better engage consumers post-purchase should also be considered.

8.1. PRODUCT DISCLOSURE STATEMENT

As discussed earlier, there has been no scientifically rigorous, empirical research conducted into how consumers actually use general insurance PDSs and the impact of the disclosure on decision-making. Without this research, the Taskforce is cautious about making recommendations about potential changes to the mandated disclosure regime.

Internal insurer testing suggests that when prompted to read the PDS, feedback from customers about its readability and comprehensibility is generally positive. This suggests that PDSs in their current form may not be bad documents, however, they are not engaging and therefore not effective as a source of information.

On the anecdotal evidence available, it is likely that while PDSs are effective at the claims stage, they are unlikely to be effective at the pre-contractual stage. A major limitation of the mandated disclosure regime is that it does not distinguish between information needs when consumers are purchasing a product as opposed to information that is needed at the claims stage.

While the PDS is comprehensive in its coverage, there is potential for more strategic engagement with consumers about select information when purchasing a product. Rather than a radically different format for the PDS, what appears to be needed at the pre-contractual stage is information/prompts to consider particular issues relevant to a consumer and to make available through a variety of channels the information needed to address those issues. Information presented outside of the PDS also provides insurers with greater flexibility in their design and content, and greater opportunity to disclose in ways that would be engaging and user-friendly.

Electronic forms of disclosure also have the potential to enable insurers to better target information that is relevant to a consumer. While the PDS fulfils an important function of setting out the comprehensive terms and conditions of a policy, electronic disclosure can enable a consumer to more easily identify the information that they are seeking.

Since 2010, there has been a number of changes to the disclosure regime to facilitate the provision of documents electronically. The recent amendments to the Insurance Contracts Act[53], which came into effect in 2013, together with ASIC Class Order 10/1219, has largely removed the legal impediments to the delivery of disclosure electronically. However, due to the need for insurers to obtain client consent to provide disclosures electronically, hard copy disclosure remains the default method of disclosure.

In July 2015, ASIC released updated guidance (Regulatory Guide 221) and two instruments providing relief from certain requirements in the Corporations Act to facilitate greater use of electronic disclosures. One of the key changes made by ASIC is to enable a product issuer to provide a disclosure document electronically without the need to seek a client's consent.

In its updated RG 221, ASIC states that disclosures may be delivered by email if the client has provided an email address as part of their contact details; the product issuer is not required to seek the client's consent. ASIC has also implemented new relief (Instrument 2015/647) that will allow disclosure using any digital method to be made (e.g. by way of hyperlink) by notifying the client that the disclosure is available; the "publish and notify" method[54].

Unfortunately, the relief/guidance provided by ASIC is unavailable to general insurers as it is confined to requirements under the Corporations Act. The disclosure requirements for insurance are not only set out in the Corporations Act, but also the Insurance Contracts Act. The question of extending the guidance/relief to cover the disclosures made under the Insurance Contracts Act is not straightforward, as ASIC is not similarly empowered to provide relief under the Insurance Contracts Act as it is under the Corporations Act.

Addressing the "consent" issue to allow insurers to provide electronic disclosures as the default method will likely require a change to the definition of "consent" under the *Electronic Transactions Act 1999*. There is also some uncertainty around whether the Electronic Transactions Act allows the delivery of disclosures through hyperlinks, and the definition of "electronic communication" may require further consideration.

[53] Insurance Contracts Amendment Act 2013.
[54] Under the "publish and notify" method, the provider must first give the client the opportunity to opt out of this method.

While the Taskforce sees immense opportunities in electronic and innovative forms of disclosure in better engaging and informing the majority of consumers, it is acknowledged that electronic communications will not be useful to consumers who can't or don't use electronic options, or paper-based disclosure is more accessible. There should be appropriate safeguards in place to ensure that paper-based disclosure remains available to consumers who need or prefer this form of communication.

Recommendation 11: The Insurance Council and industry should seek law reform to enable electronic communication as the default method of providing insurance product disclosure, consistent with current regulation of other financial product disclosures.

Recommendation 12: Insurers should explore and adopt new forms of electronic disclosure that enable information to be delivered in more relevant and personalised ways.

8.2. SHORT FORM DISCLOSURE

Given the short time since the KFS requirement has come into effect (September 2014), there has only been a limited period to observe how consumers use the document and whether it has been effective in facilitating product comparison as intended. There is a widespread industry view, shared by some consumer advocates, that the KFS is not an effective piece of disclosure.

The KFS is not a new concept in disclosure, and seems to have been used effectively for some banking products (home loans and credit cards). However, it has been observed that there are distinct differences in the KFSs provided for home insurance and banking products: banking product KFSs are disclosing items that are specific to the consumer, similar to the items that are disclosed by insurers in the Certificate of insurance/Policy schedule. The format of the KFS is likely to be more effective where there are limited variables that are the subject of disclosure.

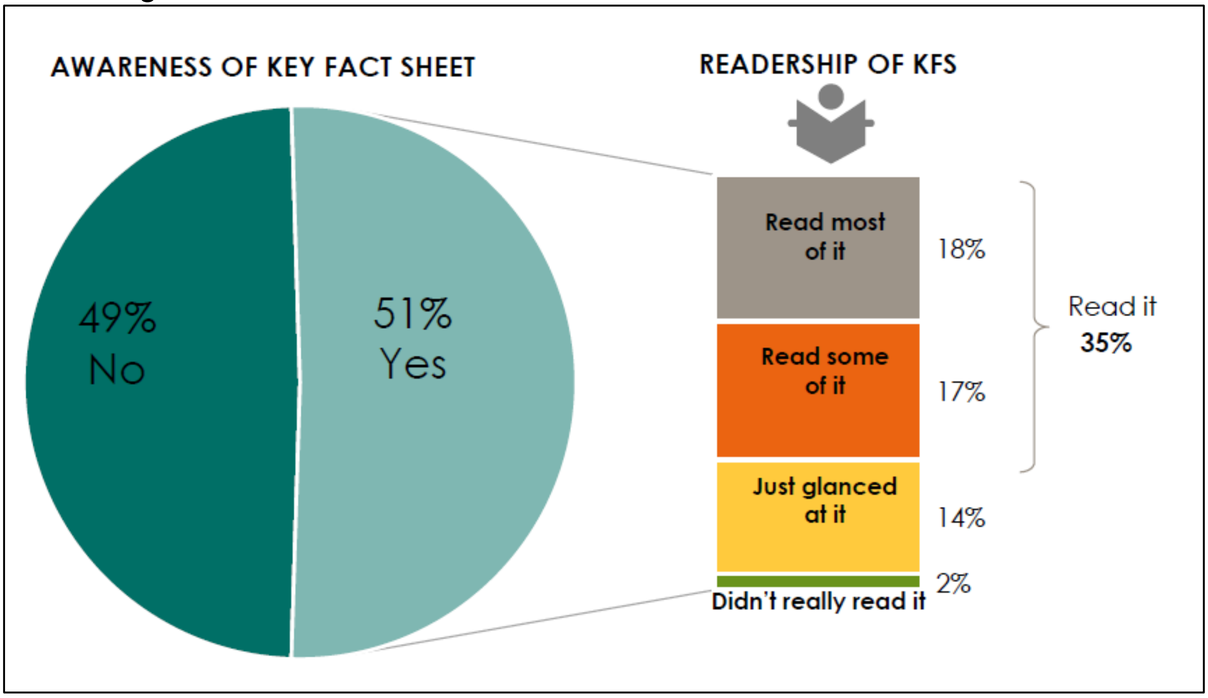
Given the lack of evidence about the impact that the KFS is having, a limited survey[55] into customer attitudes about the KFS was commissioned for the Taskforce. As discussed earlier, the Taskforce acknowledges the flaws presented by surveys relying on respondent self-reporting. However, given the time available to the Taskforce, it was felt that limited insights would still be useful. It should also be noted that the survey methodology was unable to capture insights about the value of the KFS as a comparison tool.

The survey found that half of those who renewed an existing policy or took out a new policy recall receiving the KFS. 18% read most of it; 17% read some of it; 14% just glanced at it; and 2% did not read it at all. Respondents who merely glanced at the KFS or did not read it at all cited lack of time as the key barrier to reading. Others claim it is too long, too complex

[55] Vision Critical (September 2015), Survey of Suncorp home building and contents insurance customers. Survey was conducted between 4 – 10 September. Respondents must have renewed or taken out insurance since January 2015. 301 respondents completed the survey. The survey was conducted nationally with a large majority from NSW (32%), Victoria (30%) and Queensland (21%). 49% of respondents were 50+; 37% was 35 – 49; and 14% was 18 – 34. IAG conducted the same survey of its customers that yielded consistent findings.

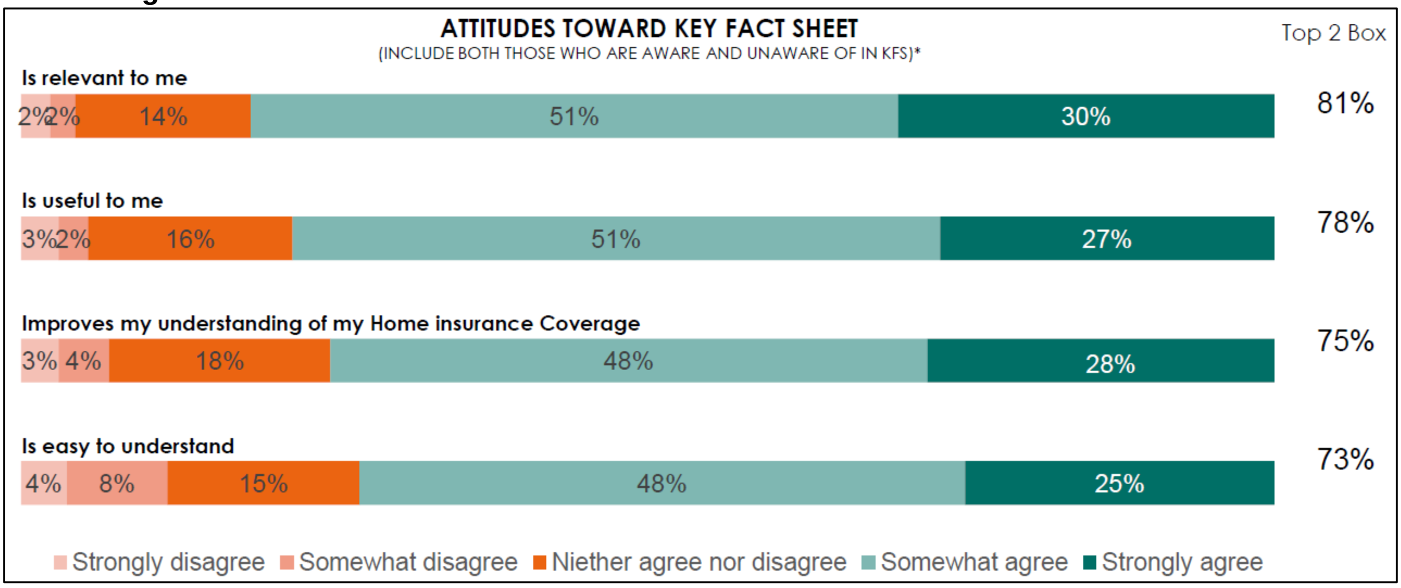
or too boring, or that they already know this information having had the policy for many years. Some did not read it immediately, but filed it for reference for when they need it.

Diagram 4: Awareness of KFS



When given the chance to review the KFS again for the purpose of the survey, the majority of respondents found the KFS to be relevant, useful and to improve their understanding of their insurance coverage. 1 in 10 found it hard to understand and a further 15% were neutral about their comprehension of the KFS. Respondents who prefer paper-based disclosure liked the KFS and they were not concerned about the double up in information received through multiple documents.

Diagram 5: Attitudes towards KFS



In addition to home insurance, almost 9 in 10 respondents think the KFS would be valuable for car insurance, and 6 in 10 perceive it would be valuable for other types of insurance they hold.

While the survey was unable to provide insights into how consumers use the KFS or their actual understanding of the content, the results suggests that short form disclosure may be useful to consumers in summarising key policy features, including its coverage and exclusions. Research should be conducted to assess whether the KFS is, or can be made to be, a useful component of pre-contractual disclosure. Before any recommendation is made about wider use of the KFS model, the benefits in relation to other retail policies should be carefully assessed, particularly with consumer testing. Testing of the KFS should form part of **Recommendation 2**.

In conducting this research, other short-form disclosure formats should also be considered. For example, through 2011 and 2012, the Government introduced a new Shorter PDS (SPDS) regime for standard margin lending, superannuation and simple managed investment products ranging from 4 – 8 pages. Originally, the SPDS regime was intended to be rolled out to more products, including general insurance.

When the KFS was announced, consideration was given to the feasibility of rolling out the SPDS regime to home insurance products instead[56]. However, the desire for quick reform favoured the introduction of the KFS, as moving insurance products into the SPDS regime required change to the Corporations Act. The ability to confine an insurance SPDS to specific products is also not easily achieved.

Given the KFS is highly prescribed, significant change would need to be implemented by regulation. While this limits the scope for the industry to make improvements to the document, the Taskforce considers that insurers should seek to simplify the language they use in the KFS; the language can be highly technical.

8.3. FINANCIAL ADVICE

One of the key findings from ASIC's report into the sale of home insurance is that limited guidance is provided to consumers over the telephone. In particular, ASIC found instances of call centre staff reading verbatim from the PDS when asked a specific question by a consumer.

Insurers have observed that proportionally fewer consumers are calling to obtain a quote; many consumers would rather obtain an online quote and call the insurer to negotiate the premium or ask specific questions about the policy. It appears that the telephone channel could be better leveraged to help consumers make informed insurance decisions. However insurers advise they are hamstrung by the risk of straying into personal advice as defined by law.

The industry has long-argued that the current regulatory framework unnecessarily constrains its ability to provide simple product information. The current personal advice regime requires

[56] Treasury (December 2011), *Key Facts Sheet for Home Building and Home Contents Insurance Policies*, Regulation Impact Statement.

onerous training for advisers; a complex needs analysis; and the comprehensive documentation of any recommendations. Consequently, the majority of general insurance is sold on a 'no advice' business model, or where advice is provided, care is taken that it falls within the less onerous definition of 'general advice'.

Suncorp recently commenced a project to review the current advice regulations and found that most messages that insurers wish to convey can fall within all three advice models depending on the way it is expressed. The difference between information that is personal advice, general advice and factual information can be minute; a single word in some circumstances. Compliance with the financial advice regime therefore inevitably focuses training for employees and agents on phrasing information so as to allow them to remain within the definition of the advice model they are operating under, rather than on delivering information that is of the most assistance to the consumer's inquiry.

This can produce counterintuitive conversations driven by compliance needs rather than consumer needs. For example, in circumstances where product options have been explained and the consumer asks direct and personal questions such as "what should I do?" it is difficult and counterintuitive not to personalise the response.

Insurers also struggle to answer questions where consumers are seeking to validate a decision. Insurers are also constrained in pointing out to consumers the shortcomings in the choices they are making. In particular, given the range of exclusions and limits which may apply to a policy, it is unlikely that many consumers have the patience to be taken through each of them over the phone by a call centre operator. There seems to be general interest in insurers bringing the consumer's attention to the exclusions/caps which could be relevant to them. However, this raises issues of potentially giving personal advice and creating liability for the insurer if an exclusion which turns out to be relevant was not specifically mentioned.

Field research conducted by IAG into the customer attitudes suggests that most consumers do not want or need advice, but require guidance in making decisions about their insurance needs. Consumers generally reacted negatively to information that was couched in authoritative terms; preferring instead experience-based and contextual information that supports independent decision-making.

However, once an insurer starts to prioritise the types of information provided to individuals, questions about whether advice is being provided are triggered. The industry is not commonly called upon to provide complex advice. However, the fear of triggering the legal definition of personal advice hinders insurers from being more forthcoming in the guidance they provide. This results in a detrimental outcome for both industry and consumers.

With increasing pressure for the industry to disclose information to consumers about their specific risks, it is anticipated that concerns about the advice regime will be exacerbated.

The Taskforce notes ASIC's view that Regulatory Guide 146 allows customer service representatives of insurers to provide more guidance than they do now, but that ASIC is open to do more to enhance the ability of insurers to provide more guidance over the phone[57]. Consumer advocates do not accept that pragmatic progress cannot be made immediately.

The Taskforce has had a general discussion with ASIC about the feasibility of developing more useful guidance that would allay industry concerns about inadvertently triggering the personal advice requirements. ASIC has indicated that it is open to a dialogue with industry to ensure that the advice regime promotes good consumer outcomes.

Recommendation 13: The Insurance Council and industry should work with ASIC and the Government to improve the advice regime in order to enable the disclosure of more targeted information to consumers. The Insurance Council should be able to report substantial progress on this recommendation within 12 months of the release of this Report.

Separately, the Government has accepted the FSI recommendation that 'general advice' should be replaced with a more appropriate, consumer-tested term to help reduce consumer misinterpretation and excessive reliance on this type of information. It will be important to ensure that this reform provides an opportunity to reconsider how the general advice regime can be made to work more appropriately for general insurance consumers. A simple re-labelling of the term “general advice” will not address the issues identified here.

8.4. PRODUCT COMPARISON

The Taskforce considers that disclosure should aim to facilitate effective product comparisons by consumers. The UK FCA[58] has recently published a report on smarter communications, noting that general insurance product comparisons are difficult because language is complex and confusing, and also because policies themselves are difficult to compare. For example, the FCA considered the specific policy features of courtesy car cover in motor insurance; and found that while most policies offer courtesy car cover, the type of car and the circumstances under which it will be provided differ. Despite the availability of clear definitions, a consumer could make assumptions about what the terminology means without making the distinctions they should by closely reading the document.

In Australia, some stakeholders see the long-standing Standard Cover provisions of the Insurance Contracts Act as providing limited value in promoting product comparison. FOS indicated to the Taskforce that the key issue is that consumers do not see the disclosures required under sections 35 and 37 of the Act. FOS would like to see greater emphasis on disclosing non-standard terms.

The Taskforce acknowledges that the opportunities presented by product innovation in enabling individualised tailoring of policies is likely to create tensions with the Standard Cover regime.

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[57] ASIC (October 2014), Review of the sale of home insurance, Report 415, paragraphs 221 – 224.

[58] UK Financial Conduct Authority (2015), *Smarter Consumer Communications*, Discussion Paper.

The Taskforce briefly considered a range of possible options that could facilitate better product comparison by general insurance consumers, including:

i) standardising the index of PDSs;

ii) improving the KFS;

iii) aggregator websites;

iv) revisiting the standard cover regime;

v) increased use of standard wordings; and

vi) an industry commitment to responsible selling of products that would help consumers assess the suitability of a product against their needs (the ultimate objective of product comparison).

Many of the above options, if introduced through regulation, could drive switching behaviour based purely on price. It is therefore recommended the industry conduct its own review of comparability options in order to determine how comparison can be improved while avoiding a potential race to the bottom which could ultimately reduce the cover made available to consumers. Any review of comparison websites should include an evaluation of the North Queensland insurance comparison website to inform whether this initiative has been effective, and if so, whether there is scope to expand its coverage beyond North Queensland.

Recommendation 14: The Insurance Council and the industry should conduct a review of product comparability options to identify methods of improving consumer understanding of coverage differences between products.

8.5. POST PURCHASE DISCLOSURE

The Taskforce considers that effective disclosure has to be relevant and timely throughout the life of a product and opportunities to better engage consumers post-purchase should also be considered. Research suggests that consumers want more frequent, meaningful and personalised communications from insurers: 45% of Australian consumers prefer to hear from their insurers at least semi-annually (currently, only 34% of consumers receive this)[59]. Increasing touchpoints with customers may address some of the misperceptions that drive the current trust deficit.

Recommendation 15: Insurers should actively identify opportunities for constructive and useful engagement with consumers through the life of a product to enhance consumer engagement.

The Taskforce also considered a request by the Consumer Action Law Centre, first suggested by the Victorian FSL Monitor, for insurers to disclose the previous year's premium on a renewal notice and explain the reason for any significant change. While the Taskforce considers that this disclosure is likely to be beneficial to consumers, this should be confirmed by consumer testing. If the consumer testing shows that this disclosure is beneficial to consumers, the Insurance Council should encourage its members to adopt the disclosure.

[59] Ernst & Young (2014), Reimagining customer relationships, Global consumer insurance survey report.

Recommendation 16: The Insurance Council should coordinate trialling of the provision of a reminder of the previous year's premium at each renewal.

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Annex 1 – Taskforce Composition and Process

In recognition of the complexity of any consideration into the role and effectiveness of disclosure, the Taskforce was established to comprise a diverse range of stakeholders. The members of the Taskforce were:

Ravi Dutta (Advisor, The Behavioural Insights Team)
Tracey Green (Executive General Manager, Product & Underwriting, IAG)
Chris Harnett (General Manager – Underwriting Agencies, QBE)
Ben Honan (Public Policy and Corporate Affairs Advisor, Suncorp)
David Leermakers (Senior Policy Adviser, Consumer Action Law Centre)
Gail Pearson (Professor, Business School, University of Sydney)

The Taskforce was chaired by Michael Gill, a Consultant at DLA Piper, and the Chair of the Insurance Brokers Code Compliance Committee. Michael has practised all aspects of insurance and reinsurance law, both in Australia and overseas for more than 40 years, and most of that time as a partner for the firm and its predecessors (mainly Phillips Fox). Michael was also the Independent Chair of the General Insurance Code Compliance Committee for 20 years.

The Taskforce also invited expert advisers to participate in its meetings, including:

- Representatives from ASIC to discuss the implications of the financial advice regulatory regime in the provision of information to General Insurance consumers;
- Representatives from the IAG customer insights team to discuss findings from IAG's research work program around engaging with customers; and
- Munich Re to discuss the reinsurance issues associated with offering total replacement home building insurance policies in the Australian market.

The Taskforce met over five sessions between July and October 2015 and remained engaged with broader insurer and consumer stakeholders in providing and receiving feedback over this period. David Leermakers liaised actively with consumer advocates, including Financial Rights Legal Centre, Legal Aid NSW, Western Community Legal Centre and Financial Counselling Australia.

The Insurance Council, which provided the secretariat for the Taskforce, kept other stakeholders apprised of the Taskforce's work, including Treasury, ASIC, the *General Insurance Code of Practice* Code Governance Committee (CGC) and the Financial Ombudsman Service (FOS). The Insurance Council actively sought feedback and data from the CGC and FOS.

Annex 2 – Financial System Inquiry Recommendation

Extract from the Financial System Inquiry Final Report (pp. 227 – 232)

Improve guidance and disclosure in general insurance

Recommendation 26
Improve guidance (including tools and calculators) and disclosure for general insurance, especially in relation to home insurance.

Description

The general insurance industry should guide consumers as to the likely replacement value for home building and contents for the purpose of insurance. If significant progress is not made by industry within a short time frame, Government should consider introducing a regulatory requirement to provide this guidance at the point of renewal or on entering into a contract with a new insurer.

The general insurance industry should enhance existing tools and calculators for home insurance, including providing up-to-date information about building costs and building code changes.

The general insurance industry should complete its work on improving disclosure in insurance product disclosure documents, including consumer testing, and providing information at the appropriate point in the sales process.

Objectives

- Reduce the incidence of inadvertent underinsurance by assisting consumers to make an informed decision about the sum insured.
- Increase the ability of consumers to make informed decisions when taking out insurance.
- Enhance consumer understanding of insurance policies, especially key features, caps and limits, and exclusions.

Discussion

Problem the recommendation seeks to address

Many stakeholders are concerned about underinsurance flowing from natural disasters and high premiums, especially in disaster-prone areas. The cost of insurance can be high, especially for coverage in higher-risk areas such as flood plains and cyclone-prone areas, leading to non-insurance and underinsurance. The Inquiry believes this issue should be primarily handled by risk mitigation efforts rather than direct government intervention, which risks distorting price signals. (For more discussion on relevant issues, see *Box 12: General insurance and natural disasters*).

Studies after natural disasters reveal inadequate levels of insurance.[63] After the Canberra bushfires in 2003, ASIC found affected consumers were underinsured by 27 per cent on average. Research undertaken by Legal Aid NSW in relation to the Blue Mountains bushfires of 2013 found, “of the 68 survey participants who were insured and had suffered a total loss of their home at the Blue Mountains, a total of 82 per cent experienced some level of underinsurance for their home building policy and/or home contents policy”.[64]

Replacement value

The current regulatory settings allow insurers to provide guidance on the replacement value of home building or contents without needing to comply with the personal advice rules.[65] At present, this is not working and insurers are not typically providing guidance on replacement value. The Inquiry believes that commercial disincentives mean insurers are reluctant to provide this type of guidance. Although many insurers provide online calculators to estimate replacement value, insurers typically refrain from giving guidance on the replacement value either over the phone or on a renewal notice. A recent ASIC report identified that most insurers operate on a ‘no advice’ or factual information model.[66]

The draft Productivity Commission (PC) report on natural disaster funding arrangements commented on a number of important issues consumers face during natural disasters, including a lack of consumer understanding about risk and insurance leading to non-insurance and underinsurance.[67] Underinsurance often occurs because most standard home building and contents insurance policies require the consumer to decide on the amount of insurance. One of the causes of underinsurance includes consumers setting their replacement value amounts too low, due to a lack of knowledge and the specialist skills required to more accurately estimate the cost of rebuilding a home and replacing home contents.[68]

The ASIC report found that “consumers frequently sought assistance from insurers about how best to decide a sum insured amount”. However, in many instances, sales staff advised they were not able to assist. Insurers have access to information that allows them to assess replacement value better than consumers. However, insurers typically do not give phone-based guidance or refer consumers to existing online tools and calculators, which would help with these replacement estimates.[69] Renewal notices also typically do not include this information. The Inquiry believes that it is important for insurers to provide guidance on replacement value to consumers to lessen the risk of underinsurance.

Tools and calculators

Tools and calculators can be updated to help consumers estimate replacement costs more accurately. The Inquiry acknowledges that the insurance market has developed some tools to address ‘estimation risk’; for instance, providing ‘uplift’ factors to sums insured, indexation or inflation adjustments to sums insured, and technological tools designed to assist consumers. However, the Inquiry sees further scope to address this issue, including the industry improving tools and calculators by referencing up-to-date building costs and changes in building codes that may affect rebuild cost. The draft PC report discussed how information imbalances may increase underinsurance due to consumers being unable to access relevant information, such as changes to building codes that may increase the cost of building a home.[70]

Disclosure

Although general insurance has a specific product disclosure regime, the industry lacks standard practice in describing a policy's key features and exclusions. The PC also commented on the difficulties consumers face in understanding the information they receive about their insurance policy.[71]

Survey results highlight that even when consumers take the time to read insurance documentation including the product disclosure statement, many misunderstand it, scan it briefly due to over-reliance on sales staff or fail to understand it due to its complexity.[72] For example, as a consequence of recent natural disasters, it became clear many consumers did not understand whether they were covered for flood. A survey by the Caxton Legal Centre after the Queensland floods of 2011 found that of participating consumers:

- 51 per cent read the policy but misunderstood important exclusions or limitations.
- 12 per cent received the policy but never read it.
- 4 per cent tried to read the policy but gave up as they could not understand it.

Conclusion

The Inquiry believes that underinsurance would reduce if, as standard practice, insurers gave consumers relevant information, guidance and advice on home building and contents insurance. Some stakeholders argue that total replacement policies would be the best solution to the issue of underinsurance. However, this may increase risk for insurers, which may exacerbate affordability issues. The Inquiry considered whether introducing standardised or default insurance products would reduce the risk of consumers failing to understand policies' key features and exclusions. On balance, the Inquiry considers the consequent reduction in competition and potential disincentive for innovation does not warrant this kind of response.

The Inquiry encourages insurers to provide consumers with enhanced guidance about likely replacement values, and to develop further and make consumers aware of tools that can help them to purchase adequate insurance cover. Industry should standardise the way replacement costs are estimated. To the extent this is limited by the existing regulatory regime, industry should work with Government to resolve. Such estimates should be given at the time of purchase, and changes to replacement costs should be communicated to consumers at each renewal.

Insurers providing consumers with enhanced guidance on replacement values would lessen the risk of underinsurance and increase confidence and trust in the sector. This may also reduce the need for governments to provide assistance after natural disasters. If, within the short term, industry has not made significant progress in providing this guidance to consumers, the Inquiry considers that Government should require industry to provide it.

The Inquiry believes the general insurance industry should complete its recent work on reducing complexity and facilitating consumer understanding of key features and exclusions, including relevant consumer testing. This work can be a useful supplement to the key facts sheet for home building insurance, which was introduced in November 2014.[73] Insurers could also incorporate elements of the key facts sheet when giving information, guidance and advice over the phone and online.

The Inquiry believes that the recommendations build on existing industry work and practices, and should have lower implementation costs than compliance with a prescriptive regulatory regime.

Box 12: General insurance and natural disasters

Many stakeholders raised concerns in relation to general insurance. The Interim Report highlighted two issues on general insurance and natural disasters:

1. The costs of insurance, especially for coverage in higher-risk areas, such as flood plains and cyclone-prone areas. It observed that increased use of risk-based pricing is likely to increase premiums in these areas.
2. The incidence of underinsurance following a natural disaster, especially inadvertent underinsurance, where homeowners underestimate the cost of rebuilding.

Cost of insurance

High premiums can lead to calls for government intervention; for example, in relation to the cost of home and strata title insurance in North Queensland. The Australian Government Actuary, which has completed two reports on the issue, attributed recent price increases to historic underpricing of coverage, higher reinsurance costs and the cost of natural disasters. It also found that insurers were providing appropriate risk-based products and pricing.[74]

The Inquiry recognises a few areas where the absence of private sector providers creates a need for governments to provide insurance; for example, for terrorism insurance or cover for catastrophic personal injuries. However, in most cases, the Inquiry considers the main role of government is to support the market in working as effectively as possible rather than subsidising prices. The costs of natural disaster insurance can be reduced through improved data, further mitigation efforts — such as building flood levies, and in the case of states and territories, by reducing the tax burden on insurance contracts (see *Appendix 2: Tax summary*). The Inquiry notes Government has recently decided to provide a comparison website for home insurance in North Queensland and has clarified that unauthorised foreign insurers may provide some competition and offer lower prices in targeted areas prone to natural disaster.[75]

Insurance coverage and underinsurance

Price competition can also help to address underinsurance. For mass-marketed insurance products, governments can play a role in encouraging comparison websites. In *Chapter 3: Innovation*, the Inquiry recommends the PC review how data can be used more effectively to enhance consumer outcomes, better inform decision making, and facilitate greater efficiency and innovation in the financial system.

Statutory insurance is insurance that is mandatory; for example, compulsory third-party motor vehicle insurance, workers' compensation insurance and professional indemnity insurance. While there are strong justifications for making some insurance cover mandatory (especially liability insurance) where the detriment is to third parties, governments imposing this requirement should take steps to encourage an adequate market (where they do not provide the cover themselves). Where governments provide insurance in competition with the private sector, this should be done on the basis of competitive neutrality.

[63] Australian Securities and Investments Commission (ASIC) 2005, *Report 54: Getting home insurance right*, ASIC, Sydney; ASIC 2007, *Report 89: Making home insurance better*, ASIC, Sydney.

[64] Legal Aid NSW 2014, Second round submission to the Financial System Inquiry, page 5.

[65] *Corporations Act 2001,* s766B(6).

[66] Australian Securities and Investments Commission (ASIC) 2014, *Report 415: A review of the sale of home insurance*, ASIC, Sydney, pages 9, 10, 47.

[67] Productivity Commission 2014, *Draft Report: Natural disaster funding arrangements,* Volume 1, Commonwealth of Australia, Canberra, page 31.

[68] Australian Securities and Investments Commission (ASIC) 2005, *Report 54: Getting home insurance right*, ASIC, Sydney, page 5.

[69] Australian Securities and Investments Commission (ASIC) 2014, *Report 415: A review of the sale of home insurance*, ASIC, Sydney, page 10.

[70] Productivity Commission 2014, *Draft Report: Natural disaster funding arrangements,* Volume 2, Commonwealth of Australia, Canberra, page 385.

[71] Productivity Commission 2014, *Draft Report: Natural disaster funding arrangements,* Volume 2, Commonwealth of Australia, Canberra, page 385.

[72] Caxton Legal Centre Inc 2011, Submission to the Standing Committee on Social Policy and Legal Affairs: Inquiry into the operation of the insurance industry during disaster events, page 16.

[73] Insurance Contracts Regulations 1985, Part 4, Division 4.

[74] Australian Government Actuary (AGA) 2014, *Second report on investigation into strata title insurance price rises in North Queensland*, Commonwealth of Australia, Canberra, pages 19–20; AGA 2012, *Report on investigation into strata title insurance price rises in North Queensland*, Commonwealth of Australia, Canberra, pages 7, 16–17.

[75] Cormann, M (Minister for Finance and Acting Assistant Treasurer) 2014, Initiatives to help address insurance affordability in North Queensland, media release, 23 October, Canberra; Senate Economics Legislation Committee 2014, *Hansard transcript*, 31 October, Commonwealth of Australia, Canberra, pages 13–25.

INSURANCE COUNCIL OF AUSTRALIA

Annex 3 – Productivity Commission Recommendation

Extract from the Productivity Commission's Inquiry into Natural Disaster Funding Final Report (pp. 216 – 218)

Information for consumers

The Commission received evidence that cognitive biases and information asymmetry in the insurance market may be inhibiting the effective use of insurance as a risk management tool. Research conducted on consumers' understanding of both their natural disaster risks and their insurance policies suggests in many cases that their understanding is poor (supplementary paper 5). This was also noted by participants.

> In our experience, many customers underestimate or are sceptical about the risks they are exposed to. (IAG, sub. 24, p. 14)
>
> Unfortunately, there is a significant information asymmetry when it comes to insurance. Many of the homeowners affected by the Blue Mountains bushfires have discovered that they are under insured, predominantly due to the lack of information on appropriate insurance coverage in bushfire areas. (Senator Doug Cameron, sub. 69, p. 3)
>
> There are many people that are not aware of their policies and the actual meaning of terms used, until unfortunately, a policy is carried out and inadequacies are exposed as occurred in 2013. There were many at that time who were not aware or took seriously the fact that their insured property and contents required updating. (Louise Markus MP, sub. DR193, p. 3)

Insurers have put a number of initiatives in place to help with consumers' understanding of their risks and insurance products. For example, as discussed earlier, the Insurance Council of Australia is developing the Building Resilience Rating Tool to provide consumers with information about the natural hazard risk to their property (section 4.1). In addition, consumers can access web-based calculators, which provide guidance on possible rebuilding costs and an appropriate sum insured. Some insurers have incorporated these calculators as part of the quote process (ICA, sub. DR185; Suncorp Group, sub. DR176). However, the 2013 Blue Mountains bushfires experience shows that web calculators can get rebuilding costs wrong (IAG, sub. DR158; Suncorp Group, sub. DR176).

The Australian Government has also regulated that insurers should provide consumers with a 'key fact sheet'. This was implemented from November 2014. The information in this fact sheet is very high level and only covers key policy inclusions and exclusions (figure 4.3). The Financial Rights Legal Centre (sub. DR130) asserted that the key fact sheet was not sufficiently tested on consumers.

Inquiry participants noted that there are some barriers to insurers providing information to policyholders, especially information that may be perceived to be personalised advice. Insurers asserted that there are regulatory barriers to giving tailored advice (Suncorp Group, sub. DR176) and in some cases, they do not have the necessary information, such as detail about how building regulations are applied at the local level (ICA, sub. DR185). The Financial

System Inquiry considered disclosure requirements in general insurance. It recommended that insurers should improve the guidance they provide to consumers, especially in relation to home insurance. The Inquiry found that 'current regulatory settings allow insurers to provide guidance on the replacement value of home building or contents without needing to comply with the personal advice rules' (Murray et al. 2014, p. 228). It concluded that the industry should standardise the way replacement costs are estimated, and to the extent that this is constrained by the existing regulatory regime the insurance industry should work with government to resolve any barriers. It also said that if the industry does not make significant progress on providing this guidance within a short time frame, government should consider introducing regulatory requirements.

Greater provision of information and continued improvements in the type and way information is provided by insurance companies to consumers about the natural disaster risks they face, how insurance products can assist them manage their risks and an indication of their residual exposure would be beneficial. Insurers should provide additional standardised information for households, such as on natural disaster risks in their area, indicative rebuilding costs and examples of household-level mitigation options.

Figure 4.3 **Insurance policy 'key fact sheet' for consumers**

What it covers	Additional information that could be provided
☑ Events covered under policy	☐ Exposure to natural hazards
☑ Specific conditions, exclusions and limits that apply to these events	☐ Whether policy is sum insured or full replacement value
☑ Whether covered for legal liability	☐ Indicative rebuilding costs
	☐ Examples of household-level mitigation options

RECOMMENDATION 4.9

Insurers should provide additional standardised information to households regarding their insurance policies, the natural hazards they face and indicative costs of rebuilding after a natural disaster. This work should be led by the Insurance Council of Australia developing guidelines, within one year, to ensure consistency in the provision and presentation of this information across insurers.