

Introduction

Referral of the Bill

- 1.1 On 24 November 2011 the Selection Committee referred the Insurance Contracts Amendment Bill 2011 to the committee for inquiry and report.

Origins and purpose of the Bill

- 1.2 During 2010-11 there were a significant number of natural disasters. In particular, severe floods affected large areas of Queensland, New South Wales and Victoria. These floods resulted in loss of life, social upheaval and significant financial costs. The aftermath of the flooding revealed that a considerable number of people had inadequate or no insurance cover. Many consumers were confused about what is covered in insurance policies and, in particular, the extent to which policies insure against flood. The Natural Disaster Insurance Review (NDIR) stated:

The fact that all home insurance policies cover storm damage including related water damage but many do not cover flood damage, which distinction is seen as arcane and artificial by many, led to a community backlash against insurers during 2011 and considerable distress, financial loss and disillusionment for many insured homeowners.¹

1 Natural Disaster Insurance Review, *Inquiry into flood insurance and related matters, Executive Summary and Recommendations*, September 2011, p. 1.

- 1.3 On 5 April 2011 the Government released a consultation paper *Reforming flood insurance: Clearing the waters*. The purpose of the paper was to engage the community in suggesting improvements to the regulatory framework and other aspects of Australia's insurance market.² The Explanatory Memorandum (EM) states:

The paper contained two key proposals designed to improve clarity for consumers in relation to insurance policies and in particular, the cover provided for various types of flood, namely, a **standard definition of flood** and the **Key Facts Sheet (KFS)** to outline the key information in relation to home building and home contents policies. The *Insurance Contracts Amendment Bill 2011* (this Bill) implements these proposals.³

- 1.4 The then Minister for Financial Services and Superannuation, the Hon Bill Shorten, MP, stated that 'these catastrophic events highlight the importance of insurance and making sure that individuals, families, communities and governments have effective insurance cover in place to guard against and recover from disasters.'⁴ Mr Shorten, in his second reading speech to the Insurance Contracts Amendment Bill, stated:

This bill delivers on the government's commitment to provide consumers – everyday individuals, modest hardworking families and striving Australian enterprises – with a better understanding of what is included in their insurance policies and in particular, the extent to which policies provide cover for flood and what cover for flood actually means.⁵

- 1.5 The Minister stated that the Bill will implement these two measures 'with the aim of helping consumers make effective decisions in relation to their insurance needs, through increased clarity and accessibility of key information.'⁶

2 Explanatory Memorandum, Insurance Contracts Amendment Bill 2011, p. 3.

3 Explanatory Memorandum, Insurance Contracts Amendment Bill 2011, p. 3.

4 The Hon Bill Shorten, MP, Assistant Treasurer and Minister for Financial Services and Superannuation, House of Representatives Hansard, 23 November 2011, p. 23.

5 The Hon Bill Shorten, MP, Assistant Treasurer and Minister for Financial Services and Superannuation, House of Representatives Hansard, 23 November 2011, p. 23.

6 The Hon Bill Shorten, MP, Assistant Treasurer and Minister for Financial Services and Superannuation, House of Representatives Hansard, 23 November 2011, p. 23.

Standard definition of flood

1.6 **Schedule 1** of the Bill amends the *Insurance Contracts Act 1984* to introduce a legislative framework for a standard definition of the term 'flood' for home building, home contents, small business and strata title insurance policies. The Minister, in his second reading speech, stated:

The definition is designed to provide a clear and easily understandable meaning for what is commonly known as riverine flooding, namely the covering of normally dry land with water that has escaped or been released from the normal confines of any lake, river, creek or other natural watercourse or alternatively, any reservoir, canal or dam.

A standard definition of flood will reduce consumer confusion regarding what is and is not included in insurance contracts. It will also avoid situations where neighbouring properties in the same street, affected by the same flood event, receive different claims assessments because the policies covering them use different definitions of flood.⁷

1.7 The current problem with flood definitions is that there are various sources of inundation that can cause damage to property. The Insurance Council of Australia (ICA) has suggested the risks can be divided into three broad categories which are summarised below:

- **A. Stormwater/rainfall runoff:** These terms refer to high intensity, short duration storms producing localised flooding. Most insurance policies (but not all) cover this risk. Some insurers also use the term 'flash flooding' with similar intent.
- **B. Riverine/inland flooding/flooding:** Inundation caused by watercourses or catchments overflowing their banks due to long duration rainfall over large areas. Some insurers provide cover for this risk, but many exclude it. Whether included or excluded, the definitions of this risk can vary greatly.
- **C. Actions of the sea/sea level rise/storm surge:** Inundation caused by movement of seawater. Few insurance policies cover this risk.⁸

1.8 The Natural Disaster Insurance Review stated:

⁷ The Hon Bill Shorten, MP, Assistant Treasurer and Minister for Financial Services and Superannuation, *House of Representatives Hansard*, 23 November 2011, p. 23.

⁸ Treasury, *Reforming flood insurance – Clearing the Waters*, April 2011, p. 3.

In the wake of the recent floods in Queensland and Victoria, a number of policyholders have reported that they were surprised that their policies did not cover the type of inundation that occurred. The majority of these cases relate to policies that do cover category A but exclude cover for category B (riverine flooding).⁹

- 1.9 A comparison of the proposed law versus the current law is shown in the following table.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
Insurance providers will be required to use a standard definition of the term flood (and all related terms) in all HBHC, small business and strata title insurance policies and their supporting documents. The term flood will be defined in regulations.	Currently the term flood is not defined in the ICA resulting in insurers defining the term in different ways.

Source *Explanatory Memorandum, Insurance Contracts Amendment Bill 2011, p. 8.*

- 1.10 The Treasury noted that the Bill does not itself mandate the use of a standard definition of flood. However, it does 'require the use of a particular definition of flood, if the word flood is used in an insurance contract.'¹⁰

Key Facts Sheet

- 1.11 Schedule 2 of the Bill amends the *Insurance Contracts Act 1984* to provide a legislative framework to allow regulations to be made to introduce a requirement for insurers to provide a key facts sheet outlining key information in relation to home building and home contents insurance. The Minister, in his second reading speech, stated:

The key facts sheet will enable consumers to access key information in relation to home building and home contents insurance policies in a concise and easy to understand format. This will assist consumers in making more appropriate decisions when entering into these types of insurance contracts.

⁹ Treasury, *Reforming flood insurance – Clearing the Waters*, April 2011, p. 3

¹⁰ Ms Sue Vroombout, Department of Treasury, *Committee Hansard*, Canberra, 8 February 2012, pp. 2-3.

In order to ensure consumers are able to effectively utilise the key facts sheet, insurers will be required to provide this document to consumers as soon as they have requested information on the particular policy.¹¹

1.12 The Minister concluded that the 'introduction of the key facts sheet will make the purchase of home building and home contents policies simpler for consumers, assisting them to compare policies with a consistent document, and facilitate more effective and informed decision making.'¹²

1.13 Currently, insurers are required to give consumers a Product Disclosure Statement (PDS) if they offer or issue an insurance policy. The EM noted that 'PDSs can be lengthy, making it difficult for consumers to access key information about the features of the policy, including the inclusions and exclusions.'¹³ The EM stated:

The KFS is a one page document that will summarise the key information about a given HBHC insurance policy, which may include:

- what is covered;
- what is not covered;
- the cooling off period;
- what type of cover is offered under the policy; and
- an explanation of how the KFS is to be used.¹⁴

1.14 A comparison of the proposed law versus the current law is shown in the following table.

11 The Hon Bill Shorten, MP, Assistant Treasurer and Minister for Financial Services and Superannuation, *House of Representatives Hansard*, 23 November 2011, p. 24.

12 The Hon Bill Shorten, MP, Assistant Treasurer and Minister for Financial Services and Superannuation, *House of Representatives Hansard*, 23 November 2011, p. 24.

13 Explanatory Memorandum, Insurance Contracts Amendment Bill 2011, p. 13.

14 Explanatory Memorandum, Insurance Contracts Amendment Bill 2011, p. 14.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
In addition to existing disclosure requirements for home building and home contents insurance policies contained in the Corporations Act 2001 (Corporations Act), insurers are required under the ICA to provide a KFS, which outlines the key information on what is and what is not covered in respect of the particular home building, home contents or home and contents insurance policy at the request of a consumer.	<p>The existing disclosure obligations in the Corporations Act require an insurer to disclose information in relation to the terms and risks associated with the insurance policy in a product disclosure statement.</p> <p>There is no disclosure requirement in the ICA for a document containing a summary of the key information to be made available to consumers for home building and home contents insurance policies.</p>

Source *Explanatory Memorandum, Insurance Contracts Amendment Bill 2011, p. 14.*

- 1.15 A draft key fact sheet used in the *Reforming flood insurance – Clearing the waters* consultation paper is shown on the next page.

Draft Key Fact Sheet: Reforming flood insurance – Clearing the waters

CONSULTATION DRAFT

KEY FACTS ABOUT YOUR HOME INSURANCE POLICY

[Insurance provider logo]

Description of your home insurance policy		
Policy name	XYZ Home Building Classic	
Policy type	<input checked="" type="checkbox"/> Sum insured	<input type="checkbox"/> Sum insured plus margin <input type="checkbox"/> Total replacement cost

How to use this statement

You can use this statement to help you to find out quickly whether this insurance policy may suit you, and you can use it for comparing the features of this policy with other policies. It is a only short summary of key benefits and exclusions and before making a decision it is important that you read the full terms and conditions in the XYZ Home Building Classic Product Disclosure Statement which can be obtained from www.insurance.xyz or by telephoning us on XXXX.

What is covered	What is NOT covered
Fire: eg damage from bushfire or fire caused by electrical fault	Damage from ash or soot if there is no fire in your home
Explosion	
Theft or attempted theft	
Stormwater/rainfall runoff	
Flood	Tsunami/actions of the sea
Impact	
Riot	
Occupier's liability	
	Other: <ul style="list-style-type: none"> landscaping, plants cars, boats

Covered amount: This policy is a 'sum insured' policy. The policy will only cover you up to fixed limits, agreed by you. You should ensure that the limits are adequate to compensate you for the losses you may have. For further information see [reference to tools to estimate the value to insure].

Need to consider risks: There may be risks such as flood, bushfire, land slippage in the area where the insured property is located. You should consider carefully whether this policy provides you with the cover you require for those risks.

Cooling Off: If you are not happy with your insurance cover, and have not made a claim, we will cancel and refund your premium in full within [XX] days of purchase.

Excess: An excess may be payable if a claim is made. The standard excess is \$XX [but this may be varied]. Please see the XYZ Home Building Classic Product Disclosure Statement [at page/paragraph XX].

Optional Cover: For an additional premium amount, we may insure items that are not standard. To find out about a range of our Optional benefits, please refer to the XYZ Home Building Classic Product Disclosure Statement which can be obtained from our website www.insurance.xyz or by telephoning us on XXXX.

CONSULTATION DRAFT

Date of effect

- 1.16 The amendments in this Bill will take effect from the date of Royal Assent. The regulations will commence two years after they are made in respect of each of the measures (the standard definition of flood and the KFS).

Release of draft regulations

- 1.17 On 9 December 2011 the Minister released draft regulations implementing the standard definition of flood in insurance contracts. The draft regulations for the key fact statement are expected to be released early in 2012.¹⁵
- 1.18 Proposed section 29D of the draft regulations provides the following meaning of flood in prescribed contracts.

Proposed section 29D Meaning of flood in prescribed contracts etc.

- (1) *For paragraph 37B (2) (a) of the Act, the word 'flood' means the covering of normally dry land by water that has escaped or been released from the normal confines any of the following:*
- (a) a lake (whether or not it has been altered or modified);*
 - (b) a river (whether or not it has been altered or modified);*
 - (c) a creek (whether or not it has been altered or modified);*
 - (d) another natural watercourse (whether or not it has been altered or modified);*
 - (e) a reservoir;*
 - (f) a canal;*
 - (g) a dam.*

15 The Hon Bill Shorten, MP, Assistant Treasurer, Minister for Financial Services and Superannuation, *Media Release*, 9 December 2011, Consultations on Draft Regulations Implementing the Standard Definition of Flood in Insurance Contracts.

- 1.19 The Minister noted that the draft regulations ‘follow the announcement by CGU Insurance to extend flood coverage based on these regulations, to all home, contents and landlord policies nationally.’¹⁶
- 1.20 The Minister commented that the ‘proposed definition is consistent with the recommendation of the Natural Disaster Insurance Review, that the Government introduce a standard definition of ‘flood’ in the form proposed in the Assistant Treasurer’s *Reforming Flood Insurance: Clearing the Waters* consultation paper.’¹⁷

Treasury Consultation

First round

- 1.21 On 5 April 2011 the Government released a consultation paper *Reforming flood insurance: Clearing the waters*, with submissions closing 13 May 2011.¹⁸ The paper aimed to engage the community in suggesting improvements to the regulatory framework and other aspects of Australia’s insurance market.
- 1.22 The paper acknowledged that:
- Following the recent experience, insurance industry and consumer representatives have made some suggestions for improving the regulatory framework and other aspects of Australia’s insurance market. The Government is giving a high priority to progressing reforms aimed at improving the insurance policy framework...¹⁹
- 1.23 The paper proposed that insurance contracts covering flood damage would follow a standard definition of flood. It also proposed a Key Facts Sheet (KFS) to outline the key information in relation to home building and home contents policies.

16 The Hon Bill Shorten, MP, Assistant Treasurer, Minister for Financial Services and Superannuation, *Media Release*, 9 December 2011, Consultations on Draft Regulations Implementing the Standard Definition of Flood in Insurance Contracts.

17 The Hon Bill Shorten, MP, Assistant Treasurer, Minister for Financial Services and Superannuation, *Media Release*, 9 December 2011, Consultations on Draft Regulations Implementing the Standard Definition of Flood in Insurance Contracts.

18 This is available at:

http://www.treasury.gov.au/documents/1995/RTF/clearing_the_waters_april2011.rtf

19 Treasury, *Reforming Flood Insurance: Clearing the Water*, April 2011, p. 1.

- 1.24 Treasury received 13 submissions in response to the paper. There were 12 public submissions and 1 confidential. Submissions are available at: <http://www.treasury.gov.au/contentitem.asp?ContentID=2039&NavID=037>.
- 1.25 There was widespread support for reform, including the development of a standard definition of flood and the Key Facts Sheet, but there was also disagreement about the precise definition of flood and the complexity and length required for the fact sheet.

Second round

- 1.26 On 9 December 2011 the then Assistant Treasurer, the Hon Bill Shorten, MP, released draft regulations to introduce a standard definition of "flood" for insurance contracts of home building and home contents (combined and individual policies). The closing date for submissions on the draft regulations was 3 February 2012.²⁰

Natural Disaster Insurance Review

- 1.27 On 4 March 2011, the Assistant Treasurer established the Natural Disaster Insurance Review (NDIR). The NDIR's final report was released on 14 November 2011. The NDIR noted that it 'was the absence of flood insurance for many policyholders, particularly in Brisbane and Ipswich, that was the primary stimulus for the Review.'²¹
- 1.28 While the NDIR commented on the need for a standard definition for flood and a key fact sheet, its terms of reference were more wide ranging. In particular, the NDIR examined the availability and affordability of insurance offered by the private insurance market, with particular reference to flood but also including other natural disasters.
- 1.29 The NDIR made 47 recommendations which focused on providing an integrated solution to the availability and affordability of flood insurance.

20 For more details on this process, see <http://www.treasury.gov.au/contentitem.asp?NavId=&ContentID=2259> and <http://www.dpm.gov.au/DisplayDocs.aspx?doc=pressreleases/2011/165.htm&pageID=003&min=brs&Year=&DocType=0>.

21 Natural Disaster Insurance Review, *Inquiry into flood insurance and related matters, Executive Summary and Recommendations*, September 2011, p. 1.

The NDIR identified the following five essential requirements that would need to be met by such a solution:

1. All home insurance, home contents insurance and body corporate insurance products need to include flood cover.
2. Discounted insurance premiums are needed for homes, home contents and home units in areas of medium and high flood risk, so as to render flood insurance affordable.
3. National coordination of flood risk measurement and mitigation is needed, in order to improve flood risk management for the benefit of the community generally and to ensure the continuing development of a competitive market for flood insurance.
4. A mechanism is needed to fund the discounts that are to be offered for affordability purposes.
5. Insurers will need access to a government-sponsored reinsurance facility if they are to deliver flood insurance discounts without compromising their own commercial positions.²²

1.30 On 14 November 2011 the government released its response to the recommendations of the NDIR. The government has sought submissions on the NDIR paper by 30 March 2012.

Objectives and scope of the inquiry

- 1.31 The objective of the inquiry is to investigate the adequacy of the Bill in achieving its policy objectives and, where possible, identify any unintended consequences.
- 1.32 The committee's role is to examine schedules 1 and 2 of the Bill, namely the definition of flood and key facts sheet. It is noted that these measures will be advanced through the development of regulations when the Bill is passed. The Treasury is undertaking a detailed consultation process on both the definition of flood and the key facts sheet.
- 1.33 The committee is not scrutinising the broader work undertaken by the NDIR which focuses on flood insurance availability and affordability.

22 Natural Disaster Insurance Review, *Inquiry into flood insurance and related matters, Executive Summary and Recommendations*, September 2011, p. 3.

- 1.34 The committee notes that the measures in the Bill are part of a broader suite of measures to address issues associated with flooding.