



National Insurance Brokers Association.



NATIONAL INSURANCE BROKERS ASSOCIATION OF AUSTRALIA (NIBA)

SUBMISSION ON REVIEW OF THE INSURANCE CONTRACTS AMENDMENT BILL

13 January 2012

ABOUT NIBA

NIBA is the voice of the insurance broking industry in Australia. NIBA represents 500 member firms and over 2000 individual Qualified Practising Insurance Brokers (QPIBS) throughout Australia. Brokers handle almost 90% of the commercial insurance transacted in Australia, and play a major role in insurance distribution, handling an estimated \$16 billion in premiums annually and placing around half of Australia's total insurance business. Insurance brokers also place substantial insurance business into overseas markets for large and special risks.

Over a number of years NIBA has been a driving force for change in the Australian insurance broking industry. It has supported financial services reforms, encouraged higher educational standards for insurance brokers and introduced a strong independently administered and monitored code of practice for members. The 500 member firms all hold an Australian financial services (AFS) licence under the Corporations Act that enables them to deal in or advise on Risk Insurance products.

ABOUT INSURANCE BROKERS

The role of insurance brokers

The traditional role of insurance brokers is to:

- assist customers to assess and manage their risks, and provide advice on what insurance is appropriate for the customer's needs;
- assist customers to arrange and acquire insurance; and
- assist the customer in relation to any claim that may be made by them under the insurance.

In doing the above the insurance broker acts on behalf of the customer as their agent. Insurance brokers offer many benefits to customers and consumers:

- assistance with selecting and arranging appropriate, tailored insurance policies and packages
- detailed technical expertise including knowledge of prices, terms and conditions, benefits and pitfalls of the wide range of insurance policies on the market
- assistance in interpreting, arranging and completing insurance documentation
- experience in predicting, managing and reducing risks
- assistance with claims and a higher success rate with settlements (about 10 per cent higher than claims made without a broker).



- in limited cases insurance brokers may act as agent of the insurer not the insured but where such a relationship exists the customer is clearly advised up front.

EXECUTIVE SUMMARY

NIBA is pleased to be able to make a submission to the House of Representatives Standing Committee on Economics in relation to the Insurance Contracts Amendment Bill 2011 (the IC Bill). As the Regulations have also been released, for convenience, NIBA also provides comments in relation to the Regulations.

The Bill deals with 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.

NIBA supports the above initiatives and any work being done to reduce the confusion for insureds whom insurance brokers represent, especially those affected by the recent floods. Overall both initiatives will be of value to consumers. NIBA has identified certain issues for further consideration which are dealt with below.

The problems these initiatives are designed to address are however complex.

Like the Council of Australian Governments (COAG) NIBA is of the view that there is a need for “a whole-of-nation resilience-based approach to disaster management, which recognises that a national, coordinated and cooperative effort is needed to enhance Australia’s capacity to prepare for, withstand and recover from disasters.”

The solution must involve a true combination of:

- Federal/State Government/local council initiatives (in particular regarding consumer education and risk prevention, management and mitigation); and
- private sector and consumer initiatives, including insurance cover.

Another crucial component is to promote the value of obtaining personal advice provided by Australian Financial Services Licensees such as Qualified Practising Insurance Brokers.

Given the complexity of insurance choice and products and the limited value of summary documents such as the Key Facts Sheet, there is no substitute for the provision of quality advice from



professionally qualified advisers such as insurance brokers in obtaining competitively priced and appropriate insurance and proactive management of an insurance claim.

NIBA sets out below its comments on the issues it has identified relevant to the above proposed changes and the legislation now before the Parliament.

STANDARD FLOOD DEFINITION CHANGES

Purpose behind the change

NIBA supports the purpose behind the change. There is no doubt that the use of a consistent definition of flood will reduce consumer confusion regarding what is and what is not included in flood coverage and avoids situations where neighbouring properties, affected by the same inundation event, receive different claims assessments because the policies covering them use different definitions of flood.

NIBA agrees that the proposed change will also improve consumers' ability to evaluate potential insurance policies and compare cover being offered by different insurers but notes that it is not the whole solution as:

- it will not assist consumers in understanding the nature of the various other inundation risks they face, including:
 - 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.
 - Actions of the sea/sea level rise/storm surge: Inundation caused by movement of seawater. Few insurance policies cover this risk.
- it will not assist consumers in identifying what form of flood risk they face. This will be important if flood cover is to be automatically offered but the insured has the ability to opt out;
- it will not address the issues that commonly arise in relation to flood claims ie. is it flood or not that was the "real or effective" cause of loss, and the operation of the Wayne Tank principle where there are concurrent causes of loss ie mixing of flood waters and storm waters where flood is excluded and storm is covered. In such a case the claim would be excluded by reason of the flood definition even though the storm water is covered. Such



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matters cause great concern and confusion for insureds and are a common area of dispute dealt with in flood insurance case law.

- despite Government attempts to simplify insurance documentation (which have continued since the introduction of the financial services reform legislation), the reality is that an insurance product is by its very nature of some complexity and consumers will not generally be inclined/or well equipped to read/understand them. The services of a professional adviser such as an insurance broker can go a long way to reducing insurance related issues.

The definition of prescribed contracts

A contract is to be a prescribed contract affected by the new requirements if the contract is entered into the day after the regulations are made (expected to be 1 July 2012) and falls within the following classes, as now defined in the draft regulations:

- home building insurance contracts described in regulation 9 of the Insurance Contracts Act (ICA);
- home contents insurance contracts described in regulation 13 of the ICA;
- insurance contracts that combine home building insurance and home contents insurance;
- contracts that provide insurance cover (whether or not the cover is limited or restricted in any way) in respect of destruction of or damage to a strata title residence;
- contracts that provide insurance cover (whether or not the cover is limited or restricted in any way) in respect of loss caused to a small business.

NIBA supports a broad extension of the provisions to such policies to avoid the errors and confusion likely to arise where different definitions are used.

NIBA expects that the representative bodies of strata entities (also known as owners corporations) will identify any definitional issues relating to strata title, given the varying definitions utilised in the various State and Territory legislation.

In relation to the definition of “*small business*”, NIBA notes that the Bill contains a more restricted definition to the Corporations Act definition for “retail clients” and the definition of “small business” under the Financial Ombudsman Service Terms of Reference. It is possible this may cause some confusion.



The Explanatory Statement (ES) to the regulations states that the definition of 'flood' has been framed in a form that:

- allows consumers to consider the extent to which the risk exists in their location;
- is suitable for insurers to express either the inclusion or the exclusion of flood cover; and
- could be adopted without impacting negatively on the extent of flood cover currently provided.

The ES states that the definition does not encompass the release of water from man-made watercourses as it is expected that insurers will cover losses from the release of water from man-made watercourses as part of the cover they provide for storm damage.

NIBA has no real concerns with the standard definition of flood itself which covers riverine/inland flooding.

However, NIBA does not believe it is the whole solution and repeats its comments under the heading "Purpose of the change" above. NIBA queries how the definition will allow consumers to "adequately consider the extent to which the risk exists in their location" if no useful public data is available on such risks.

Transition provisions - s37A

The new provisions will not apply:

- if a contract that would be considered to be prescribed contract (once the regulations are made), is entered into prior to the making of those regulations - s37A(1)(b);
- if a flood event to which the standard definition of flood applies (as provided in the regulations) occurs prior to the commencement of the regulations (commencement will be 2 years after they are made) - s37A(3); or
- in relation to a prescribed contract at any time before the transition time for the prescribed contract (ie before the commencement date of the regulations - 2 years after they are made). From this time they will apply - s37A(2).

A problem would appear to arise for insurers entering into a contract after the regulations are made that do not use the standard definition, where the period of insurance will go beyond the commencement date of the regulations (ie 2 years after regulations are made).

These insurers would appear to need to ensure that their policies do not mislead customers when issued as to what the actual definition of flood will be deemed to be post transition time.



Policy updates would be required to take this into account for at least new business and renewals offered 1 year after the regulations are made. Effectively the transition period would appear to be much less than 2 years which is of concern.

Deemed meaning of flood provisions - s37B

In a prescribed contract (or a notice or other document or information given by the insurer in relation to a prescribed contract):

- the word *flood* has the meaning given by the regulations; and
- other parts of speech or grammatical forms of that word have corresponding meanings.

The above has effect in relation to a prescribed contract (or a notice or other document or information given by the insurer in relation to a prescribed contract) even if the meaning of the word *flood* (or other parts of speech or grammatical forms of that word) provided by the contract (or the notice or other document or information) is different from the meaning of *flood* given by the regulations.

NIBA has no concerns with the above.

Obligation on insurer to clearly inform the insured s37C

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

This would only apply from the commencement of the regulations as the provisions do not apply to the insurer until that time per s37A(2). Whilst not expressly stated, this obligation would not be retrospective. An insurer having entered into a contract before the transition period ends would need to give the notice on next renewal post transition.

Sub section 11(10) of the ICA does not apply to this new section. A similar stand alone provision may be required but it would need to take into account the special transition time applicable to these requirements.

Sub sections 11(9)-(11) of the ICA relevantly provide:

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

- (a) ...



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

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

(10) Notwithstanding subsection (9):

(a) subject to paragraph (c), where, after the commencement of this Act and at or before the original entering into, or the renewal, extension or reinstatement, of a contract of insurance, the insurer has given information to the insured as required by section 22, 35, 37, 40, 44, 49 or 68, the requirement by that section to give information to the insured shall be deemed to be satisfied at or before any subsequent renewal, extension or reinstatement of the contract;

(b) sections 22 and 40 do not require an insurer to give information to the insured at or before a variation of the relevant contract of insurance except where the variation is involved in a renewal, extension or reinstatement of the contract; and

(c) sections 35, 37, 44, 49 and 68 require an insurer to give information to the insured at or before a variation of the relevant contract of insurance, but only to the extent that the information relates to the provision or provisions varied or proposed to be varied.

(11) Where a provision of this Act requires anything to be done before a particular contract is entered into, it is sufficient compliance with that provision if that thing is done at the time when the contract is entered into.

The effect of s11(10) was to make it unnecessary for the insurer to again comply with the relevant notice requirements on renewals, extensions and reinstatements provided they didn't involve a variation of the contract.

This saves the reissuing of the same notices on renewal, extension and reinstatements and unnecessary compliance costs. It would seem sensible for a similar provision to apply to the flood notice obligation so the notice need not be given if it has been provided already to the insured and there is no change ie previously the notice advised flood cover applied and on renewal or variation nothing changes.

Prescribed contracts that includes flood provisions - s37D

Where a prescribed contract includes provisions (*flood provisions*) that provide insurance cover in respect of loss or damage caused by, or resulting from, one or more flood events (whether or not the contract expressly provides insurance cover for flood as defined by the regulations), it is taken to provide insurance cover in respect of loss or damage caused by, or resulting from, flood as defined by the regulations.



The insurer under the prescribed contract may not refuse to pay a claim in respect of loss or damage caused by, or resulting from, the happening of a flood event by reason only that, but for the above, insurance cover in respect of loss or damage caused by, or resulting from, that event was not provided by the contract.

If the prescribed contract includes provisions (also *flood provisions*) that provide different maximum amounts of insurance cover in respect of different flood events, the prescribed contract is taken to provide a maximum amount of insurance cover in respect of loss or damage caused by, or resulting from, flood, as defined by the regulations, equal to the highest maximum amount (the *maximum flood cover amount*) of insurance cover provided by the contract in respect of any flood event.

The insurer under the prescribed contract may not refuse to pay an amount equal to the maximum flood cover amount in relation to a claim in respect of loss or damage caused by, or resulting from, the happening of a flood event by reason only that, but for the above, the maximum amount of insurance cover provided by the contract in respect of loss or damage caused by, or resulting from, that event was less than the maximum flood cover amount.

A *flood event* is an event that is, or would be, a flood as defined by the regulations.

NIBA supports the above provisions.

Small business obligation in proposed Insurance Contracts Amendment Regulations 2011

The regulations provide that for the purposes of entering into a contract that provides insurance cover (whether or not the cover is limited or restricted in any way) in respect of loss caused to a business, if an insurer proposes to:

- use the word 'flood' in the contract; and
- give the word a meaning other than the [standard definition];

the insurer must take reasonable steps to ensure that the contract is not a prescribed contract in respect of loss caused to a small business.

The ES notes that the "objective is to require insurers to take such steps only where the definition of flood used is not consistent with [the standard definition].... It is not necessary for an insurer to verify business size where the contract of insurance offered utilises the definition of 'flood'. This serves to minimise compliance costs for insurers."

The rationale and necessity for the imposition of such a requirement is not clear to NIBA from the ES given the way the legislation operates.



KEY FACTS SHEET (KFS)

Prescribed contracts to be covered - s33A

The new KFS requirements only apply to a prescribed contract of insurance (or potential prescribed contract) with the defined class declared in the regulations.

The regulations are yet to be released but it is intended that they will specify Home Building and Home Contents (combined and individual) (HBHC) insurance contracts in accordance with Divisions 2 (home building insurance) and 3 (home contents insurance) of Part II of the Insurance Contracts Regulations 1985.

A Product Disclosure Statement (PDS) will still need to be provided in addition to the KFS.

NIBA supports this proposal.

KFS Content - s33B

A KFS for a prescribed contract (or a potential prescribed contract), is a document that:

- contains the information relating to the prescribed contract, or the potential prescribed contract, that is required by the regulations; and
- complies with any other requirements prescribed by the regulations –s33B.

NIBA notes that the regulations specifying the relevant content are yet to be released.

However, the Explanatory Memorandum to the Bill (EM) notes:

“2.8 A KFS is a document which contains the key information relating to prescribed contracts, or potential prescribed contracts. A KFS will be required to meet content, format and provision requirements as prescribed in regulation. **[Schedule 2, item 6, paragraph 33B(a)]**”

2.9 The content, format and provision requirements for the KFS will be determined in regulations after extensive public consultation to ensure appropriate consumer and industry outcomes can be achieved.

2.10 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.

2.11 The regulations will also prescribe any other requirements in relation to the introduction of the KFS, such as the prescription of the length of the KFS. [Schedule 2, item 6, paragraph 33B(b)]”

NIBA is concerned that a one page KFS will not be likely to assist clients in *properly* understanding the nature of the cover being offered by the insurer, or in comparing products being offered by different insurers. To do so would require a level of information that is not possible to include in such a short form document.

NIBA believes that whilst it will bring some benefits to consumers (e.g assist in comparability to a certain extent), the disadvantage is that it will only ever be comparable at the minimum coverage level and in the form of a summary. Cross referencing to the PDS will always be necessary.

Consumers may end up being misled or seek to rely on this document as an explanation of the cover, rather than the PDS or the policy itself, and this can have significant consequences.

In addition, other provisions in the PDS that may be of relevance to insureds will not be dealt with. These matters can have a significant impact on the appropriateness of the policy to insureds.

Despite Government attempts to simplify insurance documentation (which have continued since the introduction of the financial services reform legislation), the reality is that an insurance product is by its very nature of some complexity and consumers will not generally be inclined/or well equipped to read/understand them. The services of a professional adviser can go a long way to reducing insurance related issues and disputes.

The preferred NIBA approach would be to have the KFS identify for clients the key concepts and differences relevant to such policies they need to be aware of and consider when reading PDSs.

NIBA believes that it is important that consumers not be led to solely rely on the content of the KFS. A notice to this effect should be clearly included on the face of the KFS. A notice that they should consider obtaining personal advice would also be worthwhile given the advantages this can have for consumers.

KFS delivery at request of consumer - s33C(1)

An insurer is obliged to provide a KFS for a prescribed contract, or a potential prescribed contract, in the circumstances, and in the manner, prescribed by the regulations.



The EM in paragraph 2.16 notes that “regulations will specify that a KFS will be required to be provided, when a consumer makes a request regarding a particular HBHC insurance contract.”

The EM also notes that:

“2.20 In some situations a consumer may not request information regarding a particular prescribed or potential prescribed contract prior to entering into the insurance contract. In this situation, the regulations are expected to take the entering into the insurance contract as a request for information regarding that contract and as such the KFS will be required to be provided at that time.”

NIBA supports the above proposals.

Method of delivery - s33C(2)

Regulations may prescribe circumstances in which a KFS may or must be provided by electronic means and they:

- have effect despite subsection 77(1).
- may prescribe exceptions to the requirement - s33C.

Currently under subsection 77(1) of the ICA notices and other documents that are required or permitted by the ICA must or may be given:

- to a body corporate in the way in which documents may be served on the body corporate; and
- to a natural person
 - personally; or
 - by post to that person’s last known address.

Whilst the EM notes in paragraph 2.31 that “Documents are not permitted to be provided electronically.” NIBA notes that this issue is open to argument and such a statement appears to be inconsistent with the approach of Federal Treasury in the previous draft amendments proposed to s77(1) in the Insurance Contracts Amendment Bill 2010 (Cth) which did not proceed. The confusion regarding the issue does however need to be resolved.

The effect of the Bill as drafted (assuming the regulations are drafted as proposed) is to clearly allow insurers to provide the KFS to a body corporate in the way in which documents may be served on the body corporate and to a natural person either personally or by post as well as by electronic means.



The EM notes:

“2.33 The provision of the KFS through electronic means will be permitted irrespective of the requirements relating to giving notices in subsection 77(1) of the ICA. [Schedule 2, item 6, subsection 33C(2)]

2.34 Circumstances where it is expected that the regulations will allow a KFS to be provided electronically include when:

- a consumer has verbally provided their email address for the purpose of being provided the KFS; and
- a consumer has sought to be provided the KFS from the insurer’s website by providing their email address electronically.

2.35 Insurers may also (or be required to) provide the KFS (in a printable form) on their websites, subject to certain criteria being satisfied.

NIBA supports the electronic provision of the KFS. Details of when this should be permitted and the obligations on insurers requires further discussion from a practical perspective.

KFS exemptions - s33C

The EM provides that:

2.28 Circumstances where it may be considered that an exemption to the requirement to provide the KFS will (consistent with the policy intent) include:

- where the insurer has already provided the consumer with a KFS for a particular HBHC insurance contract and the new KFS would be the same (except for its date).
NIBA supports this.
- where the insurer reasonably believes that another person has already provided the consumer with a KFS, and the new KFS would be the same (except for its date).
NIBA supports this.
- where the consumer has indicated that they do not wish to have a KFS provided in relation the HBHC insurance contract that they are seeking to have information on.
NIBA supports this.



Subsection 11(11) carve out

Subsection 11(11) of the ICA will not apply in relation to the KFS requirement. This provides that where a provision of the ICA requires anything to be done before a particular contract is entered into, it is sufficient if that thing is done at the time the contract is entered into.

The EM notes that:

“2.18 The timing of the request made by the consumer is not a relevant consideration for an insurer when a KFS is required to be provided. A KFS is required to be provided for both prescribed contracts and potential prescribed contracts.

2.19 The KFS is required to be provided at the time a request is made by a consumer in relation to a particular prescribed or potential prescribed contract. An insurer is not able to defer the provision of a KFS until an insurance contract is entered into.

Consideration should be given to whether such pre entry delivery, especially in telephone sale arrangements is likely to have a significant impact on the costs of insurance.

NIBA has some concerns that the provision of the KFS could lead to greater incidences of insurance not being obtained at the time of a call, potentially leaving the consumer exposed. This risk is not likely to arise where they are represented by an insurance broker providing personal advice.

Section 69 carve out

Section 69 of the ICA will not apply in relation to the KFS requirement. This section would provide relief in circumstances where the KFS notice obligation could not be complied with by providing the written notice before the contract is entered into (e.g telephone sales) where it is impractical to do so.

The EM does note that:

“2.26 However, in order to ensure that insurers can meet their requirements under Division 4 in situations where it is not practicable to provide a KFS, the regulations will provide some flexibility in the timing of their provision.”

NIBA supports such a proposal.



Insurance broker carve out

The EM also notes that:

“2.21 When a prescribed contract is entered into through an insurance broker. Under subsection 71(1) of the ICA any requirement (other than subsection 58(2)) an insurer is not required to give a document to an insured before the contract is entered into if the contract was arranged by certain insurance brokers acting as agents of the insured.

2.22 Under subsection 71(1) of the ICA any requirement (other than subsection 58(2)) an insurer is not required to give a document to an insured before contract is entered into if the contract was arranged by certain insurance brokers acting as agents of the insured.

2.23 The requirement to provide an insured with a KFS before entering into a contract will not apply if the contract to which the KFS was to be provided was arranged by the type of broker that was acting as agent of the insured as provided in subsection 71(1).”

NIBA supports this proposal as the client is represented by a professional adviser in such cases.

Obligation to clearly inform not met by KFS - s33D

The ICA requires insurers to ‘clearly inform’ insureds of any derogation from the standard cover provided for prescribed contracts under section 35 of the ICA. The requirement to ‘clearly inform’ must be in writing and may be satisfied by providing the insured a document or documents containing provisions or relevant provisions that outline the derogation.

In order to satisfy the ‘clearly inform’ requirements under the ICA, the requirement must be made in writing. In order to achieve this, insurers may use as many or as few documents as they require. However, in most cases insurers use the insurance contract and it’s associated Product Disclosure Statement (as required under the Corporations Act) to satisfy their ‘clearly inform’ requirements.

As the KFS is only a guide providing the key information about a particular HBHC insurance contract, the provision of a KFS will not be able to be used as a mechanism for satisfying the insurers need to clearly inform insureds of any derogation in their particular policy.

Depending on the content of the KFS this seems harsh and if the relevant information is provided in the KFS and meets the requirements, NIBA does not see why it should not be a method of compliance.

Offences

An insurer commits an offence if:

- the insurer is subject to the KFS requirement; and



- the insurer engages in conduct (means do an act; or omit to perform an act); and
- the conduct contravenes the requirement.

Penalty: 150 penalty units.

The insurer bears the evidentiary burden in relation to any defences for not providing the KFS, as these are matters that are within their knowledge and/or control which NIBA supports.

Transition period issues

There do not appear to be any transition provisions relevant to this provision in the Bill itself. However, the Explanatory Memorandum states that “the regulations in relation to the measures in this Bill (the standard definition of flood and the KFS) will commence two years after the day the regulations are made in respect of each of the measures.”

It appears the transition period for the KFS obligations will be specified in the regulations which are yet to be released. Similar issues to those raised in relation to the flood provisions need to be considered.

If you would like to discuss any aspect of this matter further do not hesitate to contact us.

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