

1 May 2019

By email: insurance@acc.gov.au

ACCC Northern Australia Insurance Inquiry
GPO Box 520
Melbourne VIC 3001

Dear Madam / Sir

Submission: Northern Australia Insurance Inquiry – First Interim Report

Thank you for the opportunity to comment on the draft recommendations in the Australian Competition and Consumer Commission (ACCC) Northern Australia Insurance Inquiry First Interim Report (**Report**).

We strongly support the ACCC's important work on insurance pricing and the operation of insurance markets in northern Australia. Many of the Report's findings and recommended reforms will benefit Victorian insurance consumers.

We agree with the ACCC that Government and industry should take quick action on the 15 recommendations, and not wait until the end of the 3-year inquiry. Many of the recommendations have been made in previous inquiries.

This submission comments on the recommendations and draft recommendations on:

- Unfair contract terms laws
- Mandating standard cover
- Sum-insured proposals
- Insurance broker commissions
- Cash settlement

We also provide additional comments on:

- Advertising
- Use of technology

About Consumer Action

Consumer Action Law Centre is an independent, not-for profit consumer organisation based in Melbourne. We work to advance fairness in consumer markets, particularly for disadvantaged and vulnerable consumers, through financial counselling, legal advice and representation, and policy work and campaigns. Delivering assistance services to Victorian consumers, we have a national reach

through our deep expertise in consumer law and policy and direct knowledge of the consumer experience of modern markets.

Recommendation 5: Review and mandate standard cover

We strongly support this crucial recommendation.

It is fair to say that standard cover¹ is not a reality. In effect, we have no minimum standard for insurance and no benchmarks for comparison. The experience of consumers in external dispute resolution schemes indicates that standard cover is rarely raised by consumers in disputes with insurers, and when standard cover is raised, it appears to provide little recourse for consumers.

In our view, the options and issues which should be considered are:

1. Updating the features of the existing standard cover regime to meet modern community standards and expectations. It is unlikely that a regime developed without significant consumer input in the early 1980s is fit for purpose today.
2. Making standard cover a mandatory minimum standard for insurance policies.
3. Developing a 'rating' system which rates products against the standard cover benchmark.

Recommendation 6: Unfair contract terms (UCT) should apply to insurance

We strongly support this recommendation.

We agree with the ACCC that effective UCT laws require:

- that unfair terms be made illegal, not simply voidable;
- a broad range of remedies including compensation for affected consumers, civil pecuniary penalties and infringement notices.

Our views on the appropriate model for extending UCT laws to insurance contracts are detailed in our submission to The Treasury's Proposals Paper, *Extending unfair contract terms protections to insurance contracts* (June 2018).²

We note and endorse Commissioner Hayne's Recommendation 4.7 in the Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (**Financial Services Royal Commission**).³ Commissioner Hayne specifically recommended that the main subject matter of an insurance contract should be narrowly defined 'as the terms of the contract that describe what is being insured'. This feature will be critical to an effective model, to ensure that all relevant terms are reviewable under the UCT laws. Otherwise, unfair exclusions, conditions and

¹ *Insurance Contracts Regulations 2017* (Cth), pt 3 div 1.

² Available at: <https://policy.consumeraction.org.au/2018/08/27/submission-extending-unfair-contract-terms-protections-to-insurance-contracts/>.

³ Financial Services Royal Commission, *Final Report*, 1 February 2019, Volume 1 (**Final Report**), Recommendation 4.7, available at: <https://financialservices.royalcommission.gov.au/Pages/reports.aspx>.

benefits could continue causing unfair outcomes for Australians. A broader definition of 'main subject matter' would render the reform useless.

Recommendation 9: Disclose the costs that count towards 'sum insured'

We support this recommendation.

It is clear that some consumers have little trust in sum insured calculators, particularly where the estimate is higher than expected. This distrust may be exacerbated by the indexation of sum insured, which may be seen as price gouging by some. We note that the NSW Emergency Services Insurance Monitor found potential over-insurance caused by auto-adjustment of sum insured amounts on renewals:

Increasing the sum insured each year can be important as a way to avoid under-insurance, but over-insurance can also be a problem. Hence, the case for requiring automatic escalation of the sums insured on renewing policies should not go unquestioned. Nevertheless, putting aside the question of whether such an annual escalation might be reasonable, the Insurance Monitor's data does confirm that the average sum insured on renewal policies has mostly been higher than that on new policies in the past three years.⁴

Disclosing the costs that count towards the sum insured may help to build trust in sum insured calculators.

We also refer to and endorse Recommendations 47-49 of the Joint Consumer Submission to the *General Insurance Code of Practice 2017 Review: Interim Report*:⁵

- A requirement should be included under the Code for insurers to provide access to an accurate and informative sum insured calculator as part of the home building insurance application process.
- Insurers should commit to regular reviews and auditing of the sum insured calculators and where an error is identified with a calculator that the insurer commits to correcting the calculator and informing any affected consumers.
- If a sum calculator is used in the sales process, this information should be recorded and kept on a policyholder's file.

We recommend that the ACCC incorporate these recommendations in its final report.

⁴ NSW Emergency Services Insurance Monitor, Discussion Paper, *Pricing Differences: New vs Existing Customers*, November 2018, p 30, available at: https://www.esinsurancemonitor.nsw.gov.au/sites/default/files/DiscussionPaper_Pricing_New%26Renewals_FINAL.pdf.

⁵ Available at: https://financialrights.org.au/wp-content/uploads/2018/02/180119_GICOPReviewInterimReport_Submission_FINAL.pdf.

Recommendation 10: Disclose the premium, sum insured and excess on a renewal notice

We strongly support this recommendation.

Changes to renewal notices should be consumer tested to ensure that the particular form of the proposed wording and placement is effective.

Recommendation 11: Extend the ban on conflicted remuneration to insurance brokers

We strongly support this recommendation.

In our view, conflicted remuneration should be banned for all general insurance products. Conflicted remuneration is a root cause of many problems exposed at the Financial Services Royal Commission. A blanket ban would simplify the law, reduce the risk of regulatory arbitrage and close the loopholes which have been created through industry lobbying.

We are deeply concerned by the Report's findings that some brokers argued against reducing premiums because it would reduce the commissions earned by brokers. This alone supports the case for a ban on conflicted remuneration.

Mere disclosure of commissions is not sufficient to overcome. Disclosure of commissions is intended to alert a consumer to the potential for an adviser, broker or other person selling a product to be conflicted because of how they are being remunerated. However, research in the UK on mortgage broking has shown this to have the opposite effect. One study found that consumers interpreted commission disclosure as mortgage brokers being more honest.⁶

Insurance brokers that provide valuable services to their customers have little to fear from a fee-for-service model.

Draft Recommendation 1: Insurers should estimate a sum insured for customers

We support this draft recommendation. Insurers have relevant information about the risks and an understanding of the impact of underinsurance – more so than a person who has not yet made a claim. However, this reform will only assist consumers if the estimate is accurate.

The ACCC should also consider applying this requirement to new policies, not just renewals.

There should not be any negative consequences for any consumer who elects not to set their sum insured at the level estimated by the calculator. That is, a consumer should not forgo any rights or be in any way penalised. This is particularly important given the low level of trust in sum insured calculators, as found by the ACCC. Many consumers will remain sceptical – particularly following the revelations of the Financial Services Royal Commission – and it is a matter for the general insurance

⁶ James Lacko and Janis Pappalardo, *The effect of mortgage broker compensation disclosures on consumers and competition: A controlled experiment*, Federal Trade Commission Bureau of Economics Staff Report (February 2004), available at: <https://www.ftc.gov/reports/effect-mortgage-broker-compensation-disclosures-consumers-competition-controlled-experiment>; cited in Financial Services Authority, *Consumer Research 69: Financial Capability: A Behavioural Economics Perspective* (July 2008), available at: <https://www.ftc.gov/reports/effect-mortgage-broker-compensation-disclosures-consumers-competition-controlled-experiment>.

industry to rebuild lost trust. The aim of the reform should be to reduce information asymmetry between insurer and insured, and ensure suitable insurance products, not penalise consumers who still struggle to engage with or trust the estimate provided.

Draft Recommendation 11: Giving consumers more control over how their claims are settled

We broadly support this recommendation. Giving consumers the right to choose will give consumers greater certainty during claims handling.

However, the terms of the cash settlement must also be fair.

From a consumer perspective, claims handling is the most critical part of the insurance process, and one of the most problematic. It is clear that insurers' current cash settlement practices do not meet community standards or expectations, and that these types of clauses should not continue to operate to the detriment of consumers, during what can be one of the worst times in their lives emotionally and financially.

For example, AAI's AAMI home building insurance cash settlement clause allows AAI to settle a claim for a 'reasonable cost', being 'the amount we determine. Reasonable cost is the lesser amount of any quotes obtained by us and/or by you. Discounts may be available to us through our suppliers.'⁷ This means that AAI can settle a claim for less than it would cost the insured person to repair or rebuild the home, irrespective of the sum insured. AAI submitted to the Financial Services Royal Commission that this clause did not fall below community expectations and standards, because the 'PDS is clear: AAI will pay the amount it would cost AAI to repair or rebuild.'⁸

In our view, the AAI PDS and submission to the Royal Commission fundamentally misunderstand what the community expects of insurers, particularly considering that people make home building insurance claims at some of the worst time of their lives, financially and personally.⁹ This position also disregards the reality that the way AAMI advertised its home building insurance product did not reflect the PDS, and that, in any case, it is well-established that very few people read or understand insurance product disclosure documents.¹⁰

To address this problem, Commissioner Hayne stated (quoting The Treasury):

⁷ AAMI, *Home Building Insurance: Supplementary Product Disclosure Statement* (19 January 2018) <<https://www.aami.com.au/aami/documents/personal/home/spds-building-05-03-2018.pdf>>.

⁸ AAI, Round 6 Insurance: Submissions on behalf of AAI re natural disaster insurance, 1 October 2018, [25].

⁹ The 'intangible' social costs of natural disasters—including increased mental illness, risky alcohol consumption, chronic diseases, family violence and short-term unemployment—have been estimated to be at least as high as the tangible, physical costs: see Deloitte Access Economics, 'The economic cost of the social impact of natural disasters' (Report, March 2016) <<http://australianbusinessroundtable.com.au/assets/documents/Report%20-%20Social%20costs/Report%20-%20The%20economic%20cost%20of%20the%20social%20impact%20of%20natural%20disasters.pdf>>.

¹⁰ Justin Malbon and Harmen Oppewal, (*in*) *Effective Disclosure: An experimental study of consumers purchasing home insurance* (2018) <<https://australiancentre.com.au/wp-content/uploads/2018/09/InEffectiveDisclosure-final.pdf>>; Insurance Council of Australia, 'Consumer Research on General Insurance Product Disclosures' (Research findings report, February 2017) <http://www.insurancecouncil.com.au/assets/report/2017_02_Effective%20Disclosure%20Research%20Report.pdf>.

'terms that permit an insurer to pay a claim based on the cost of repair or replacement that may be achieved by the insurer, but could not be reasonably achieved by the policy holder' are terms that may be unfair if [unfair contract terms] applied to insurance.¹¹

The problems with unfair and inadequate cash settlement of insurance claims should also be addressed by:

1. Bringing claims handling within section 912A of the Corporations Act; and
2. Bringing insurance contracts under the unfair contract terms regime, and specifying as an example of an unfair term a policy clause which allows an insurer to cash settle a claim for an amount which would not enable the insured to complete the necessary works (within the policy sum insured).

These issues are currently under consideration by The Treasury.

Additional comments

Advertising

We encourage the ACCC to consider the impact of advertising and sales pitches, and whether this contributes to a disparity between what the consumer expects, and what the insurance policy delivers.

As the cases studies of Allianz, AAI and CommInsure showed during the Royal Commission, the problem is not the disclosure regime alone. It is also advertising—an effective and engaging form of product disclosure—which can mislead people as to the key features of products. In addition, sales scripts and practices, such as those seen in the ClearView and Freedom case studies, can also mislead people and inhibit them from deciding whether a product would be suitable for them. The disparity between sales pitch and reality further undermines the disclosure regime.

Use of technology

Beyond sum insured calculators, the general insurance industry should also harness the potential of data and technology to provide consumers with more suitable products. Technology is increasingly being used by insurers to hone their own marketing, underwriting and claims assessment processes – it should also be used to ensure product suitability.

Some potential uses may include:

- asking comprehension questions to ensure that customers understand the key features of a policy before they purchase';
- using non-text and accessible information to ensure that people with a range of English and comprehension levels can find out what a policy covers;
- requiring online customers to answer 'knock out' or filter questions to assess whether they can claim on a policy, and whether it covers what they are most likely to claim for.

¹¹ Above n 5, p308.

Contact details

If you have any questions about this submission, please contact Cat Newton, Senior Policy Officer, at cat@consumeraction.org.au or on 03 9670 5088.

Yours sincerely

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