

Chapter 3

Transparency and the current product disclosure regime

Information asymmetry

3.1 Information asymmetry arises whenever one party to an economic transaction has more or better information than the other party. While information asymmetry can, in some instances, lead to undesirable outcomes, its effect is not always negative in a well-functioning market.

3.2 A competitive and efficient insurance market requires consumers to be well-informed. Information asymmetry that favours insurers can hinder consumer decision-making because of a lack of understanding about premium pricing, policy coverage and personal risk. This can, in turn, lead to poor consumer outcomes, such as inflated premiums, underinsurance, or coverage that is inappropriate to their needs.

3.3 Consumers' ability to make efficient and appropriate choices with respect to insurance can be impeded by the absence or inaccessibility of relevant information. In other words, information asymmetries can arise in circumstances where:

- consumers cannot access the information they need (e.g. insurers not providing information); or
- consumers have access to relevant information, but it is not in a usable format (e.g. it is too complex).¹

3.4 The second of these circumstances is of particular relevance to general insurance. A lack of transparency in the general insurance industry with regard to disclosure has resulted in significant barriers to consumers' ability to make efficient use of product information. This issue is exacerbated by the inherent complexity of general insurance products.

3.5 The Consumer Action Law Centre (Consumer Action) succinctly captured this issue in its submission:

The general insurance industry in Australia is characterised by a vast range of policies which include varied conditions, inclusions, exclusions and definitions. Policies are not consistent and do not conform to a minimum standard. Choosing a product can be a complicated attempt at guesswork. This is largely due to the lack of transparency in insurance products.²

3.6 Similarly, Professors Fels and Cousins submitted that:

The complexity of home insurance as currently marketed by the insurers, and the lack of transparency in its pricing, makes it harder for consumers to be knowledgeable about the product relative to suppliers. In short,

1 Productivity Commission, *Natural Disaster Funding Arrangements—Inquiry Report*, Vol. 2, December 2014, p. 434.

2 Consumer Action Law Centre, *Submission 5*, p. 2.

information asymmetry exists because of the high costs of being informed. As a result of this, consumers exhibit inertia in shopping around.³

The current product disclosure regime

3.7 The principal means of disclosure for retail classes of general insurance, including home and motor policies, is the mandated provision of a Product Disclosure Statement (PDS) to a consumer at the point of sale.

3.8 The current product disclosure regime for general insurance was first introduced as part of the broader Financial Services Reforms (FSR) in 2001. The objective of these reforms was to consolidate regulation of the financial services sector and, by extension, give consumers a more consistent framework of consumer protection in which to make their financial decisions.⁴ The new disclosure regime aimed to supplement, but not replace, the disclosure requirements already existing under the Insurance Contracts Act.

3.9 Under the current disclosure regime, insurers are obliged to comply with a number of mandatory requirements, as set out in Chapter 7 of the *Corporations Act 2001* (Corporations Act). For direct sales to a consumer, insurers must provide a PDS at the point of sale. The Corporations Act also prescribes the content that is required to be covered in a general insurance PDS. In broad terms, a PDS must provide information about the features and benefits of the policy being sold, including its terms, conditions, limits and exclusions.

3.10 When insurance is sold through an intermediary, such as an insurance broker, the intermediary must provide the consumer with a Financial Services Guide (FSG). An FSG must disclose information about the financial services offered, remuneration arrangements, and any potential conflicts of interest. For general insurance policies, the FSG can be combined with the PDS in a single document.⁵

3.11 As previously noted, for home building and contents policies, insurers must also provide consumers with a one-page Key Facts Sheet (KFS). In accordance with the Insurance Contracts Act, the KFS provides an overview of key policy features in a standard format. This additional disclosure requirement was introduced as part of a response to the Queensland flood events of 2011.

3.12 The objective of the current disclosure regime, as stated 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'.⁶

3.13 A number of stakeholders noted that, while the existing disclosure regime came from a place of good intent, its interpretation and application was shaped by the

3 Professor Allan Fels AO and Professor David Cousins AM, *Submission 23*, p. 4.

4 See Financial Services Reform Bill 2001, *Explanatory Memorandum*, p. 1.

5 QBE, *Submission 16*, p. 10; Insurance Council of Australia, *Submission 13*, p. 21.

6 *Corporations Act 2001*, ss. 1013D(1).

prevailing view at the time that more information was better for consumers. As acknowledged by Mr Rob Whelan, Executive Director and Chief Executive Officer of the Insurance Council of Australia (ICA), this traditional view 'has led to a position in some cases where the PDSs are lengthy, onerous documents to be able to get through as a mechanism for imparting information'.⁷

Behavioural biases

3.14 CHOICE also noted the shortcomings of this outdated view on disclosure; in particular, the fact that it does not take into account the substantial role that behavioural biases play in shaping consumers ability to make efficient economic decisions:

Traditionally the role of disclosure was based on a theory that consumers are rational agents who will make welfare maximising decisions if provided with full information. While this theory has long been questioned, policy and regulation has been slow to catch up. Traditional models assume economic agents, such as consumers, have an infinite capacity to take in and process information; are neutral to how it is presented; can anticipate and take the future into account; care only about self-maximising; and treat gains the same as losses. In contrast, behavioural economics recognises that consumers have limits on the amount of information they can take in; are affected by presentation; tend to be poor at anticipating the future; care about people and fairness; and are more concerned about losses than gains. These are known as 'behavioural biases'.⁸

3.15 ASIC also discussed this issue, observing that the perceptions underlying existing disclosure regulation are out of step with contemporary understanding of consumer behaviour:

The rationale for relying on disclosure to protect and empower consumers assumes that consumers are rational decision makers who, when given information about a financial product, will be able to read it, and as a result of doing so, understand the product. However, consumer research, psychology and behavioural economics indicate that a consumer's decision making is affected by behavioural biases.⁹

Government and industry action to date

3.16 The efficacy of disclosure practices for general insurance has come under increasing criticism in recent years, largely driven by numerous natural catastrophe events and subsequent inquiries into the industry.

3.17 The Queensland flood events of 2011 resulted in a number of people being adversely affected due to inadequate general insurance cover. Government consultation on this issue highlighted a level of consumer confusion regarding what is

7 *Proof Committee Hansard*, 12 April 2017, p. 30.

8 CHOICE, *Submission 17*, pp. 9–10.

9 Australian Securities and Investments Commission, *Submission 22*, p. 12.

and is not included in their insurance contracts; in particular, the extent to which contracts provide cover for flood and what flood cover means.¹⁰

3.18 In an effort to reduce this confusion and enable consumers to make better informed decisions about the purchase of insurance contracts, the Parliament passed legislation amending the Insurance Contracts Act in 2012. This legislation provided a legislative framework for a standard definition of flood and, as previously noted, to require insurers to provide a KFS for home building and contents policies.¹¹

3.19 The general insurance industry has also responded to concerns raised with regard to the existing disclosure regime and its potentially detrimental effect on consumer outcomes. As discussed in chapter 1, in 2015, the ICA established the Effective Disclosure Taskforce (the Taskforce) to investigate and develop initiatives for improvement with regard to product disclosure for general insurance.

3.20 In its report to the Insurance Council Board, the Taskforce observed 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.¹²

Deficiencies in the current disclosure regime

3.21 The remainder of this chapter examines in detail the deficiencies of the current disclosure regime for general insurance as raised by participants in the inquiry. To this end, it also explores how the lack of transparency in the existing disclosure regime could be addressed to assist with consumer understanding and facilitate comparability between products.

Pricing transparency at the point of sale

3.22 The risk-based nature of general insurance makes it a relatively complex financial product, as premiums are bespoke to individual consumers. From a consumer perspective, this complexity is obfuscated by a lack of transparency with regard to how general insurance is priced.

10 Insurance Contracts Amendment Bill 2012, *Explanatory Memorandum*, p. 7.

11 Insurance Contracts Amendment Bill 2012, *Explanatory Memorandum*, pp. 11, 19.

12 Effective Disclosure Taskforce, *Too Long; Didn't Read: Enhancing General Insurance Disclosure*, October 2015, p. 3.

3.23 Professors Fels and Cousins emphasised this point in their submission:

Few consumers would disagree that insurance is a relatively complex product. The pricing of insurance also generally lacks transparency. The pricing of insurance is largely based on (amongst other things) technical risk factors, including the risk of a claim occurring due to various types of natural and non-natural peril events, however not many consumers—particularly purchasers of home insurance—would have a level of financial literacy that is sufficient to enable them to understand how this pricing works.¹³

3.24 During the course of the inquiry, the committee canvassed a number of options to improve the transparency of general insurance pricing. In particular, the committee considered the disclosure of the previous year's premium on insurance renewal notices and component pricing of insurance premiums.

Disclosure of the previous year's premium

3.25 Several submitters proposed that the disclosure of the previous year's premium on renewal notices for home, strata and car insurance would be a simple but effective way of increasing transparency around premium pricing. As well as encouraging product comparability, some reasoned that such an approach would also improve competitive tension in the general insurance market.¹⁴

3.26 CHOICE argued that the disclosure of the previous year's premium 'would allow a consumer to assess any increase and decide if they should seek alternative quotes'.¹⁵ Similarly, ASIC contended that 'any unexplained significant price increase should prompt consumers to shop around for alternative policies that may better suit their needs'.¹⁶

3.27 Support for this strategy can be found in the United Kingdom. In 2014, the Financial Conduct Authority (FCA) trialled the provision of different types of information at renewal to test whether this prompted consumers to switch. The trial, which was conducted with over 300 000 consumers, found that:

The inclusion of last year's premium on renewal notices had the greatest impact, prompting between 11% and 18% more people to either switch provider or negotiate a lower premium when prices sharply increase.¹⁷

13 Professor Allan Fels AO and Professor David Cousins AM, *Submission 23*, p. 9.

14 See, for example, Financial Rights Legal Centre, *Submission 9*, p. 18; CHOICE, *Submission 17*, p. 12; Australian Securities and Investments Commission, *Submission 22*, p. 27.

15 CHOICE, *Submission 17*, p. 12.

16 Australian Securities and Investments Commission, *Submission 22*, p. 27.

17 Financial Conduct Authority, *FCA to require insurance firms to publish details of last year's premium*, Press Release, 3 December 2015, <https://www.fca.org.uk/news/press-releases/fca-require-insurance-firms-publish-details-last-year%E2%80%99s-premium> (accessed 3 June 2017).

3.28 The ICA noted that, as part of its work on implementing the recommendations made by the Effective Disclosure Taskforce, it is also facilitating a trial of the disclosure of the previous year's premium at renewal. The ICA further advised that:

The objective of this disclosure is to enhance transparency around any premium changes for renewing consumers. Two insurers have committed to trialling this disclosure, and the Insurance Council is facilitating information sharing across the industry around the impact of such disclosure on consumer behaviour. If the trials result in positive consumer outcomes, wider implementation of this disclosure can be encouraged.¹⁸

3.29 IAG is one of the insurers trialling this approach, implementing disclosure of year-on-year premium comparison on the Renewal Certificate for its NRMA Insurance Comprehensive Motor policy in 2016.¹⁹

3.30 In addition to disclosing the previous year's premium, the Financial Rights Legal Centre (Financial Rights) asserted that insurers 'should also explain why the price has increased'.²⁰ The ICA expressed a similar view, stating that:

...adequate explanation of why there has been a movement in that premium also is required, because a simply bold-faced comparison of two numbers actually is misleading. That is because, for example, asset prices increase, therefore they have to have a different sum insured and that can change the premium rate. If you compare that to the previous year, it looks different and you have not explained why the difference is. You have to be able to explain these numbers and not just have a bold-faced number. That means that the insurers have to go to some lengths to be able to do that accurately.²¹

3.31 However, IAG raised concerns with regard to this proposal, commenting that there are practical difficulties in providing such information on every insurance renewal:

We have not got to that yet on every individual insurance renewal, because for every renewal the price is made up of many, many different components and being able to explain that on every insurance renewal would be beyond the bounds of practicality. Clearly, when customers speak to us then we would try and explain to them. Often there is a bit of a constraint on our customer-facing people to be able to do that at an individual policy level, but they would certainly be able to talk generally around the reasons why there might be pressure on insurance premiums.²²

18 Insurance Council of Australia, *Submission 13*, p. 20.

19 IAG, *Submission 15*, p. 26.

20 Financial Rights Legal Centre, *Submission 9*, p. 18.

21 Mr Rob Whelan, Executive Director and Chief Executive Officer, Insurance Council of Australia, *Proof Committee Hansard*, 12 April 2017, p. 34.

22 Mr Anthony Justice, Chief Executive, Australian Consumer Division, IAG, *Proof Committee Hansard*, 12 April 2017, p. 45.

3.32 While there has been broad industry support for this particular change to disclosure around premium pricing, ASIC advised that 'legislative change would be required to compel all insurers to do this'.²³ Financial Rights echoed this view, submitting that disclosure of the previous year's premium on renewal notices:

...would need to be mandatory for all insurers as encouraging a voluntary disclosure of this sort would encounter problems from those insurers (especially smaller insurers) wishing to avoid being the first to move.²⁴

Disclosure of component pricing

3.33 The committee also examined the disclosure of component pricing as a possible means of increasing the transparency around premiums for home, strata and car insurance.

3.34 Financial Rights advocated strongly for this proposal, arguing that by requiring insurers to provide information as to the components in their premium pricing, consumers will be better informed about their personal risk. Moreover, Financial Rights emphasised that this approach would provide consumers with increased understanding about 'what effect mitigation strategies may have on reducing insurance premiums or what behaviours or conditions might increase premiums'.²⁵

3.35 Financial Rights explained that component pricing would provide a 'signal to consumers of the risk factors taken into account when premiums are set', also making the point that this 'risk signal' would be particularly helpful in parts of Australia that face severe weather risks.

3.36 In support of this proposal, Mrs Margaret Shaw, herself a North Queensland resident, commented that:

With regard to transparency, with any type of insurance there is no breakdown of how premiums have been calculated, and so people cannot work on improving certain areas. In most cases, there is no option to opt out of unwanted cover. We do not even know what the cyclone component is.²⁶

3.37 When questioned by the committee about the potential for component pricing at an individual product level—that is, breaking a premium down into broad factors such as the base premium, taxes, cyclone and flood components—Mr Whelan from the ICA told the committee:

Yes, I think that is possible. An interesting part of that is the amount that goes on top of the base premium, taxes, which we quite happily point out to consumers.²⁷

23 Australian Securities and Investments Commission, *Submission 22*, p. 27.

24 Financial Rights Legal Centre, *Submission 9*, p. 18.

25 Financial Rights Legal Centre, *Submission 9*, p. 17.

26 Mrs Margaret Shaw, private capacity, *Proof Committee Hansard*, 13 April 2017, p. 12.

27 Mr Rob Whelan, Executive Director and Chief Executive Officer, Insurance Council of Australia, *Proof Committee Hansard*, 12 April 2017, p. 32.

Product transparency at the point of sale

3.38 As previously noted, for retail classes of general insurance, the PDS is the principal means of disclosure to a consumer at the point of sale. A PDS must provide information about the features and benefits of the policy being sold, including its terms, conditions, limits and exclusions.

3.39 In the years since their introduction, PDS documents have come to be perceived by government, consumer groups and the insurance industry alike as overly complex, lengthy and not conducive to consumer comprehension. Research into consumers' buying behaviours has consistently found that few consumers read the PDS when buying general insurance products.²⁸

3.40 For example, in 2013–14, ASIC commissioned research into consumer behaviours when purchasing home insurance.²⁹ The research found that:

...two in every 10 consumers (20%) who took out new insurance or considered switching read the PDS. However the qualitative research undertaken as part of our review in REP 416 found that 'reading' the PDS generally meant reading selected pages, not all of it.³⁰

3.41 As emphasised by several inquiry participants, the current form and content of PDSs can result in poor consumer understanding of what their general insurance policies actually cover. As a consequence, consumers may not learn what they are covered for, or in fact, not covered for, until an event occurs for which they need to make a claim. Moreover, the complexity of PDS documents, including their generally considerable length and use of complex and sometimes inconsistent terminology, impedes product comparability. This difficulty in making like-for-like comparisons between product offerings can result in consumers selecting a product on the basis of price alone, rather than considering a product's value or whether it provides a level of cover appropriate to their needs.³¹

3.42 Mr John Rolfe emphasised the difficulties that consumers face when trying to compare general insurance products using PDS documents:

There are novels that are shorter than product disclosure statements. It is extraordinary. They run to 30,000 words. It would take hours to read just one of them. So let's say you were going to look at half a dozen of them before you picked an insurer. It is beyond belief that anyone would do that. So no-one is ever really going to know the detail of their insurance product.³²

28 See Effective Disclosure Taskforce, *Too Long; Didn't Read: Enhancing General Insurance Disclosure*, October 2015, pp. 17–20.

29 See Susan Bell Research, *Insuring your home: Consumers' experiences buying home insurance*, ASIC Report 416, October 2014.

30 Australian Securities and Investments Commission, *Submission 22*, p. 11.

31 See, for example, iSelect, *Submission 6*, p. 5; CHOICE, *Submission 17*, p. 10; Victorian Council of Social Service, *Submission 18*, p. 12.

32 Mr John Rolfe, private capacity, *Proof Committee Hansard*, 12 April 2017, p. 4.

3.43 The inefficacy of existing PDS documents as a tool for enabling informed consumer choices is exacerbated for consumers prone to having low financial literacy, such as people for whom English is a second language or low-income earners. Good Shepherd Microfinance emphasised this point, submitting that PDSs 'are impenetrable to most of us, let alone those who have low levels of literacy and numeracy'.³³

Industry perspective

3.44 Industry stakeholders that appeared before the committee were aware of the issues raised with regard to PDS documents, and noted that 'effective disclosure has been a priority project for the industry over the past two years'.³⁴ However, some industry stakeholders also made the point that much of the content of PDSs is mandated by legislation and, as such, is beyond industry control.

3.45 For example, Mr Nicholas Scofield, General Manager of Corporate Affairs at Allianz, informed the committee:

I know our home PDS has about 17,000 words; five thousand of those are regulated by the government. We have to put them in, whether they are about privacy, the duty of disclosure, the financial ombudsman service, the HIH Claims Support Scheme—there is a whole lot of regulated content.³⁵

3.46 Some industry representatives also noted that there are certain restrictions imposed by the current regulatory framework that prevent insurers 'from doing some of the things we would like to do' with regard to product disclosure.³⁶ For example, QBE submitted that, 'under the current regulatory regime, an insurer's ability to communicate electronically with its customers has been constrained and is still restricted'.³⁷

3.47 ASIC also commented on the current restrictions to electronic disclosure in its submission to the inquiry, explaining that:

In July 2015, ASIC made two new legislative instruments to remove barriers to electronic disclosure in the Corporations Act.

...

Provisions in the Insurance Contracts Act and *Electronic Transactions Act 1999* may prevent some insurers from relying on aspects of the relief we provided for electronic disclosure in 2015 under these instruments. ASIC

33 Good Shepherd Microfinance, *Submission 8*, [p. 4]. See also Victorian Council of Social Service, *Submission 18*, p. 12.

34 Mr Rob Whelan, Executive Director and Chief Executive Officer, Insurance Council of Australia, *Proof Committee Hansard*, 12 April 2017, p. 26.

35 *Proof Committee Hansard*, 12 April 2017, p. 59.

36 Ms Kate O'Loughlin, Head of Government Relations and Industry Affairs, QBE Insurance Australia and New Zealand, *Proof Committee Hansard*, 12 April 2017, p. 61.

37 QBE, *Submission 16*, p. 10. See also Insurance Council of Australia, *Submission 13*, p. 24.

does not have powers to address these issues; legislative change would be required.³⁸

3.48 The committee understands that ASIC is currently working in consultation with the industry and Treasury on this issue and encourages the continuation of this work.

A case for standard insurance

3.49 As previously discussed, a well-recognised shortcoming of the current disclosure regime for general insurance is the difficulty that consumers face in comparing products on a like-for-like basis, and the implications that this can have regarding consumers' ability to make informed decisions when buying insurance.

3.50 Submitters to the inquiry raised a number of regulatory and industry barriers to product comparability that, if addressed, could increase the efficacy of product disclosure for the benefit of consumers. These include the operation of the standard cover regime under the Insurance Contracts Act and inconsistent use of policy terms across the industry.

Standard cover regime

3.51 As noted in the previous chapter, Part 5 of the Insurance Contracts Act and related regulations set out the standard cover requirements for a number of prescribed classes of general insurance contracts, including home and motor insurance. Under the current standard cover regime, an insurance contract can provide less than standard cover if:

- the insurer 'clearly informed the insured in writing (whether by providing the insured with a document containing the provisions, or the relevant provisions, or the proposed contract or otherwise)'; or
- 'the insured knew, or a reasonable person in the circumstances could be expected to have known' that the insurance contract provided less than the standard cover, or no cover.³⁹

3.52 As explained by Mr Gerard Brody, Chief Executive Officer of the Consumer Action Law Centre, 'the idea of standard cover was that people could expect a basic level of cover and could compare a particular policy to the standard'.⁴⁰

3.53 However, some submitters argued that the standard cover regime is no longer fulfilling its intended purpose, and that the way the regime has been framed in legislation makes comparison between general insurance products 'nigh on impossible'.⁴¹ This is because, under the current product disclosure regime, an insurer

38 Australian Securities and Investments Commission, *Submission 22*, p. 29.

39 *Insurance Contracts Act 1984*, ss. 35(2), as cited in Consumer Action Law Centre, *Submission 5*, p. 7.

40 *Proof Committee Hansard*, 13 April 2017, p. 7.

41 See, for example, Consumer Action Law Centre, *Submission 5*, p. 8; Financial Rights Legal Centre, *Submission 9*, p. 30.

can comply with the requirement to 'clearly inform' a consumer when a contract provides less than standard cover simply by providing them with a PDS.

3.54 Mr Brody elaborated on this deficiency of the standard cover regime:

The problem is that all an insurer has to do to comply with the standard cover regime is give the consumer a product disclosure statement. This is a ridiculously low bar. Case in point: the recently published industry commissioned research shows that 80 per cent of people do not read their PDS when they buy insurance. It is fair to say that standard cover is not a reality. We have no minimum standard for insurance and no benchmarks for comparison.⁴²

3.55 Mr Brody went on to propose that 'standard cover could be revived to provide some kind of default cover or safety net, but it would require much more from the industry than a PDS'.⁴³

3.56 Similarly, Mr Dallas Booth, Chief Executive Officer of the National Insurance Brokers Association of Australia (NIBA), suggested that it is timely for a review of the standard cover provisions with input from the insurance industry, government and consumer groups.⁴⁴ Mr Booth also contended that:

I believe that if we can have a comprehensive review of those standard form covers, people would not have to receive, would not have to read a PDS statement because they would get the cover that they are expecting to receive. We have certainly suggested to government very recently that it is time for those form provisions in the contracts act and regulations to be reopened and to be thoroughly reviewed.⁴⁵

Standard definitions

3.57 Several submitters raised the inconsistent use of definitions across insurance policies as a barrier to product comparability, and proposed standardisation of key policy terms as a way of helping to address this issue.⁴⁶

3.58 Given the complexity of general insurance products and associated disclosure documents, inconsistent definitions risk misleading consumers into thinking they have cover for certain events when in fact they do not.⁴⁷

42 Mr Gerard Brody, Chief Executive Officer, Consumer Action Law Centre, *Proof Committee Hansard*, 13 April 2017, p. 7.

43 Mr Gerard Brody, Chief Executive Officer, Consumer Action Law Centre, *Proof Committee Hansard*, 13 April 2017, p. 7.

44 Mr Dallas Booth, Chief Executive Officer, National Insurance Brokers Association, *Proof Committee Hansard*, pp. 13–14.

45 *Proof Committee Hansard*, p. 14.

46 CHOICE, *Submission 17*, p. 13; Financial Rights Legal Centre, *Submission 9*, p. 30; iSelect, *Submission 6*, p. 5; Consumer Action Law Centre, *Submission 5*, p. 10.

47 CHOICE, *Submission 17*, p. 12.

3.59 CHOICE elaborated on this point, submitting that:

A good disclosure process can be defeated if key definitions are not standardised. This is particularly the case in insurance where a definition, potentially hidden 100 pages deep in a PDS, can radically alter the value of a policy.⁴⁸

3.60 Mr Michael Saadat from ASIC echoed this view, commenting that:

...where there are differences in definitions, it is not always possible for consumers to appreciate the nuances that those differences can create and, if you do have a different definition, what the implications of that are from a coverage perspective.⁴⁹

3.61 Regulatory action has been taken in the past to address the inconsistent use of definitions in insurance, with a standard definition of 'flood' introduced for home and contents policies in 2012. This move to standardise the definition of flood was considered by the general insurance industry and consumer groups as a positive step to improving consumer outcomes.⁵⁰ However, as noted by CHOICE, 'it did not deal with the broader systemic problem in insurance sales' and 'there remain a slew of terms which appear to have different definitions depending on the policy'.⁵¹

3.62 CHOICE emphasised this point by providing the example of the term 'actions by the sea':

For example, home insurers use different definitions for 'actions of the sea'. ANZ excludes loss or damage caused by 'actions by the sea' however it does not define a tsunami as an action by the sea and will in fact cover loss or damage caused by a tsunami. By contrast Coles considers a tsunami to be an act of the sea and excludes damage or loss 'caused by high tide, tidal wave, tsunami or other actions of the sea'.⁵²

3.63 Industry representatives expressed some reservations regarding proposals to standardise policy terms. For example, in giving evidence to the committee, Mr Whelan from the ICA remarked that standard definitions could 'commonise the market'.⁵³

3.64 However, in responding to questions on notice, the ICA noted that its Effective Disclosure Taskforce had 'identified possible benefits from proposals such

48 CHOICE, *Submission 17*, p. 12.

49 Mr Michael Saadat, Senior Executive Leader—Deposit Takers, Credit and Insurers; Regional Commissioner—New South Wales, Australian Securities and Investments Commission, *Proof Committee Hansard*, 12 April 2017, p. 69.

50 See Insurance Council of Australia, *Insurance Council welcomes Standard Definition of Flood*, Media Release, 18 June 2012.

51 CHOICE, *Submission 17*, pp. 12, 17.

52 CHOICE, *Submission 17*, p. 12.

53 Mr Rob Whelan, Executive Director and Chief Executive Officer, Insurance Council of Australia, *Proof Committee Hansard*, 12 April 2017, p. 34.

as the use of standard definitions' and that the ICA will be undertaking work to improve product comparability in consultation with regulators and consumer groups.⁵⁴

3.65 Mr Scofield from Allianz also expressed a general willingness of the industry to consider standardising definitions, remarking that:

I think we would all agree that having a standard definition of flood has been of great advantage to the industry and to consumers. I do not think we would be averse to standardising some other definitions like actions of the sea in a similar way.⁵⁵

Efficacy of Key Facts Sheets

3.66 As previously discussed, legislative changes requiring insurers to provide consumers with a Key Facts Sheet (KFS) for home building and contents policies were introduced in 2012. This was done in an effort to reduce confusion and enable consumers to make better informed decisions about the purchase of insurance contracts.⁵⁶

3.67 The contents, format and provision requirements for the KFS is prescribed by regulation.⁵⁷ In broad terms, the KFS provides information on whether a policy provides cover for each of a number of listed events, as well as any specific conditions, exclusions or limits that apply to each event. Ms Alexandra Kelly, Principal Solicitor at the Financial Rights Legal Centre, summarised the intent behind the KFS as an effort to 'try and inform the consumer, in a clear snapshot, of the key facts about the product'.⁵⁸

3.68 During the course of the inquiry, the committee examined the effectiveness of the KFS as a means of improving consumer outcomes when buying insurance. Some inquiry participants expressed concerns regarding how the KFS is being implemented and proposed that there is scope for improvement in how it is used.

3.69 For example, Ms Kelly contended that the KFS is not meeting its intended purpose, commenting that:

It had a good intention, but it was not consumer tested. What we have seen, and we have reviewed hundreds of key fact sheets over the years of various products, is that some of them are so poor they just say, 'Refer to your product disclosure statement'; others are almost misleading with oversimplification of what is in them. In my experience of answering the hotline, and I have answered thousands of calls, only one consumer has ever raised it with me as being something that has actually informed them

54 Insurance Council of Australia, answers to questions on notice, 12 April 2017 (received 5 May 2017).

55 Mr Nicholas Scofield, General Manager, Corporate Affairs, Allianz Australia Insurance Limited, *Proof Committee Hansard*, 12 April 2017, p. 57.

56 Insurance Contracts Amendment Bill 2012, *Explanatory Memorandum*, p. 7.

57 Insurance Contracts Amendment Regulation 2012 (No. 2).

58 *Proof Committee Hansard*, 12 April 2017, p. 17.

about their cover. In my view, it does not meet the intention it was designed or suggested to try and meet.⁵⁹

3.70 Mr Booth from NIBA expressed a similar view, arguing that the KFS has resulted in an oversimplification of what is covered by relevant policies and is therefore potentially misleading to consumers:

The key facts sheet was introduced approximately two years ago. I think it was a federal government initiative. At the time, we expressed concerns that a key facts sheet would result in oversimplification of the terms of the policy. We believe that that has happened and we believe that there are examples particularly in relation to home buildings and home contents policies, where the key facts sheet could actually be quite misleading to the relatively uninformed consumer. We have expressed concerns to government and to relevant authorities that the key facts sheet in its current form is an oversimplification of policy terms and conditions and can be not only unhelpful but in fact in some circumstances misleading.⁶⁰

3.71 Industry representatives also commented on the tendency of the KFS to oversimplify insurance policies. For example, Mr Scofield from Allianz noted that two distinct policies can appear to offer the same insurance cover from the information provided on their respective KFS:

I can tell you that we have a key fact sheet for our defined events policy, where you are covered for listed events like earthquake, fire et cetera, and we have a key fact sheet for our accidental damage policy, which provides a broader coverage, because it will cover things that get damaged, in a sense, through just about any cause. The only difference between our two key fact sheets for those two policies are the two words at the top that say defined events or accidental damage. They are very different policies. One has a much broader level of coverage and will as result have a higher premium.⁶¹

3.72 Ms Kelly suggested that the KFS could be redesigned, but stressed that consumer testing would be required if this was to occur.⁶² Similarly, Mr Brody from Consumer Action articulated that 'what we have not seen is a detailed evaluative study of those key facts sheets' and that this 'would be a useful step in determining what sort of disclosure actually works'.⁶³

59 Ms Alexandra Kelly, Principal Solicitor, Financial Rights Legal Centre, *Proof Committee Hansard*, 12 April 2017, p. 17.

60 Mr Dallas Booth, Chief Executive Officer, National Insurance Brokers Association of Australia, *Proof Committee Hansard*, 12 April 2017, p. 10.

61 Mr Nicholas Scofield, General Manager, Corporate Affairs, Allianz Australia Insurance Limited, *Proof Committee Hansard*, 12 April 2017, pp. 56–57.

62 Ms Alexandra Kelly, Principal Solicitor, Financial Rights Legal Centre, *Proof Committee Hansard*, 12 April 2017, p. 17.

63 Mr Gerard Brody, Chief Executive Officer, Consumer Action Law Centre, *Proof Committee Hansard*, 13 April 2017, p. 11.

Committee view

3.73 Transparent disclosure that encourages understanding and promotes informed decision-making lies at the heart of robust consumer protection. To that end, the committee is deeply concerned by the apparent lack of transparency in the general insurance industry with regard to product disclosure, and the detrimental effect this has on consumers' ability to effectively compare similar insurance policies.

3.74 The committee recognises the efforts being made by the general insurance industry, led by the Insurance Council of Australia, to improve product disclosure practices and encourages the continuation of this work. However, the committee is of the view that more needs to be done to support and protect consumers in purchasing general insurance products appropriate to their needs.

3.75 The committee shares stakeholder concerns that some aspects of the current product disclosure regime for general insurance are ineffective in enabling consumers to make informed decisions. Evidence received during the inquiry highlighted several areas of the existing disclosure regime and regulatory framework for general insurance that are not operating to support consumer outcomes, and would benefit from considered review and possible legislative reform. The committee broadly agrees with the opportunities highlighted and, as such, makes the following recommendations.

Recommendation 3

3.76 The committee recommends that the government strengthen the transparency of general insurance pricing by amending the product disclosure regime in the *Corporations Act 2001* to require insurers to:

- **disclose the previous year's premium on insurance renewal notices; and**
- **explain premium increases when a request is received from a policyholder.**

Recommendation 4

3.77 The committee recommends that the government initiate a review of component pricing to establish a framework for amending the *Corporations Act 2001* to provide component pricing of premiums to policyholders upon them taking out or renewing an insurance policy, as well as an assessment of the benefits and risks to making such a change.

Recommendation 5

3.78 The committee recommends that the government initiate an independent review of the current standard cover regime with particular regard to the efficacy of current disclosure requirements.

Recommendation 6

3.79 The committee recommends that the government work closely with industry and consumer groups to develop and implement standardised definitions of key terms for general insurance.

Recommendation 7

3.80 The committee recommends that the government undertake a review of the utility of Key Facts Sheets as a means of product disclosure, with particular regard to the:

- effectiveness of Key Facts Sheets in improving consumer understanding of home building and contents policies; and
- merit of extending the use of Key Facts Sheets to other forms of general insurance.