Chapter 5

Other matters raised

5.1 During the inquiry, participants raised a number of other matters of concern; including, the exemption of insurance from the unfair contract terms regime, the payment of insurance commissions to strata managers, and the role of disaster mitigation in lowering insurance premiums. This final chapter provides an overview of these matters.

Unfair contract terms

5.2 As noted in chapter 2, insurance contracts, including those for general insurance products such as home and motor insurance, are currently exempt from the unfair contract terms (UCT) provisions under the *Australian Securities and Investments Act 2001* (ASIC Act).[1] The UCT provisions apply to all other standard form contracts of the financial services sector.

5.3 The UCT provisions were introduced as part of the broader national Australian Consumer Law.[2] They provide consumer protections from terms in standard form contracts which unfairly advantage a trader over a consumer, and which cause the consumer detriment.

5.4 Several inquiry participants raised strong concerns regarding the exemption of insurance contracts from the UCT regime, arguing that this exemption creates a significant gap in consumer protections.[3] For example, Ms Emma King from VCOSS commented that:

> It is astonishing that insurance contracts are currently the only type of consumer contract that are excluded from the protections of consumer law. This means fundamentally, many insurance contracts sold are simply not worth the paper they are written on.[4]

5.5 The Financial Rights Legal Centre (Financial Rights) contended that 'arguably insurance is the area where consumers most need protection from unfair terms because consumers insure their main assets'.[5] CHOICE echoed this view in its submission, asserting that the complexity of general insurance contracts requires 'an additional layer of protection against harmful terms':

---

1 UCT provisions do not apply to terms regulated by the *Insurance Contracts Act 1984*.

2 The UCT provisions in the ASIC Act mirror the Australian Consumer Law, Chapter 2 Part 2–3. ASIC has responsibility for enforcing the consumer protection provisions, including the UCT laws, in the ASIC Act in relation to financial products and services.

3 See, for example, Financial Rights Legal Centre, *Submission 9*, p. 29; Consumer Action Law Centre, *Submission 5*, pp. 2, 12; CHOICE, *Submission 17*, p. 13.

4 Ms Emma King, Chief Executive Officer, Victorian Council of Social Service, *Proof Committee Hansard*, 13 April 2017, p. 19.

5 Financial Rights Legal Centre, *Submission 9*, p. 29.

> Contracts extend over pages of information, few people read or understand them, and they contain complex terms which most consumers are unlikely to understand. As a consequence, consumers suffer detriment by having claims denied due to the mismatch between what they thought the policy covered and what was actually covered.[6]

5.6 Mr Gerard Brody from the Consumer Action Law Centre (Consumer Action) contended that 'insurance policies are riddled with terms which on their face could be unlawful if unfair contract term laws applied to insurers'. Mr Brody provided the example of cash settlement clauses in home insurance policies:

> [Cash settlement clauses] allow many insurers to settle a home building claim with a one-off cash payment. This means that if someone loses their home or a flood of fire, an insurer can get a quote on the rebuild with all their bulk trade discounts and just pay that amount. It can bear little resemblance the real costs for someone rebuilding their home. The unfair contract regime has resulted in fairer contracts and industry practices across the board in other consumer markets. To us it is a no-brainer that it has to be extended to insurance.[7]

5.7 ASIC also expressed its support for the extension of the UCT provisions to insurance contracts, telling the committee that 'we think it would add to the regulatory regime in a beneficial way for consumers'.[8]

5.8 Insurance contracts are currently excluded from the UCT regime on the grounds that consumer protections are adequately met by the 'duty of upmost good faith' obligations under the Insurance Contracts Act (see paragraph 2.16).

5.9 When questioned by the committee about whether insurance contracts should be included under the UCT regime, Mr Rob Whelan from the Insurance Council of Australia (ICA) advised that 'we have long held that there are very ample protections for consumers under the existing legislation. The Insurance Contracts Act offers many remedies for consumers and protections already'.[9] Representatives from IAG concurred with this view, commenting that 'we believe there is sufficient regulation and contractual protection in the existing regime'.[10]

---

6 CHOICE, *Submission 17*, p. 13.

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

8 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.

9 Mr Rob Whelan, Executive Director and Chief Executive Officer, Insurance Council of Australia, *Proof Committee Hansard*, 12 April 2017, p. 33.

10 Mr Anthony Justice, Chief Executive, Australian Consumer Division, IAG, *Proof Committee Hansard*, 12 April 2017, p. 47.

5.10 However, some submitters argued that the duty of upmost good faith obligation does not provide sufficient protection for consumers and that application of the law has proved to be ineffective.[11]

5.11 CHOICE contended that, compared to the UCT provisions, the duty of upmost good faith 'is unclear and jurisprudence is imprecise'. Similarly, Consumer Action submitted that the mechanism of upmost good faith 'has proved inaccessible, ineffective, or both', and that 'it does not protect consumers from broad exclusions or other clauses in insurance contracts that would likely be "unfair"'.[12]

5.12 Moreover, Consumer Action indicated that not only does the duty of upmost good faith provide little protection for consumers, it can bias judicial proceedings in favour of insurers:

> The duty of utmost good faith provides very little to customers, as far as we can tell. We have looked at court decisions and ombudsman decisions, and very rarely has that helped a consumer in a dispute with an insurer. What the duty does do is help insurers deny claims on the basis of alleged fraud or where someone is not cooperating with a claims process or not providing information. There is no evidence that the duty of utmost good faith is working as a consumer protection, as far as we can tell.[13]

Committee view

5.13 General insurance plays an important role in maintaining the financial stability of consumers, and indeed, of the Australian economy. Given this, effective protections are essential during all stages of a consumer's relationship with an insurer. The committee is of the view that the exemption of general insurers from the unfair contract terms provisions contained in the ASIC Act is unwarranted and creates a significant gap in consumer protections.

Recommendation 11

5.14 The committee recommends that the government introduce the legislative changes required to remove the exemption for general insurers to unfair contract terms laws.

Commission payments to strata managers

5.15 Some inquiry participants raised the matter of commission payments made to strata managers—also known as body corporate managers depending on the relevant state or territory legislation—in return for purchasing insurance on behalf of the members of a strata title scheme. In particular, some inquiry participants raised concerns about the transparency of disclosure of commissions to strata scheme members, and whether such arrangements represent a conflict of interest.

---

11 Consumer Action Law Centre, *Submission 5*, p. 12; CHOICE, *Submission 17*, p. 14.

12 Consumer Action Law Centre, *Submission 5*, p. 12.

13 Ms Susan Quinn, Senior Policy Officer, Consumer Action Law Centre, *Proof Committee Hansard*, 13 April 2017, p. 11.

5.16 The following section briefly describes the regulatory framework that applies to strata managers with regard to purchasing insurance and the disclosure of commissions received for performing such functions. An overview of concerns raised and comments made during the inquiry in relation to insurance commission payments is then provided.

Regulatory framework

5.17 By purchasing into a strata title scheme, the owners of strata title properties become members of a legal entity commonly referred to as a body corporate.[14] Normally, the functions, duties and powers of a body corporate, including the purchase, renewal and management of statutory insurances, are delegated to a strata managing agent. This delegation is provided for in the relevant state or territory strata legislation. A strata manager is appointed by a body corporate by entering into a strata management agreement.

5.18 With regard to the purchase of insurance, market practice is that a strata manager will negotiate cover through an insurance broker or specialist underwriting agency. Under a strata management agreement, strata managers can be paid a commission as remuneration for arranging and managing insurance on behalf of a body corporate. Such commissions are legally paid to strata managers in their capacity as either an authorised or distributor representative of an Australian Financial Services (AFS) Licensee;[15] in this case, an insurance broker or underwriting agency. As explained by Allianz:

> In terms of insurance commission payments, generally speaking, insurance brokers and underwriting agencies are paid a commission by the relevant insurer for placement of insurance business, and the insurance broker or underwriting agent may then pay on part of that commission to the strata manager who assisted in placing that insurance business in the capacity as their representative – in accordance with the terms of the agency agreement between them.[16]

5.19 With regard to the disclosure of remuneration arrangements, including insurance commissions, strata managers are bound by federal financial services legislation. Under the Corporations Act, strata managers appointed as representatives of an AFS Licensee are required to provide a body corporate with a Financial Services Guide (FSG). In accordance with the Act, an FSG must include:

> (f) information about the remuneration (including commission) or other benefits that any of the following is to receive in respect of, or that is attributable to, the provision of any of the authorised services:

---

14 Depending on the relevant state or territory legislation, a body corporate can also be known as an owners corporation, strata company, or community association.

15 In performing the function of arranging strata insurance on behalf of a body corporate, strata managers are considered under the *Corporations Act 2001* as providing a 'financial service'. In order to provide a financial service, a company or person must either hold an Australian Financial Services (AFS) Licence or be appointed as a representative by a Licensee.

16 Allianz, answers to questions on notice, 12 April 2017 (received 4 May 2017).

(i) the providing entity;

(ii) an employer of the providing entity;

(iii) the authorising licensee, or any of the authorising licensees;

(iv) an employee or director of the authorising licensee, or of any of the authorising licensees;

(v) an associate of any of the above;

(vi) any other person in relation to whom the regulations require the information to be provided…[17]

5.20 Information about product pricing must also be disclosed to the body corporate in a Product Disclosure Statement (PDS) for the relevant strata insurance product. Moreover, as representatives of an AFS Licensee, strata managers are obligated under the Corporations Act to 'have in place adequate arrangements for the management of conflicts of interest that may arise' in the provision of financial services.[18]

5.21 In addition to federal legislation, strata managers are also bound by the disclosure requirements set out in the relevant state or territory legislation. For example, in New South Wales, the *Strata Schemes Management Act 2015* (NSW) requires commission arrangements to be disclosed at the annual general meeting of a body corporate.

5.22 In some jurisdictions, strata managers are also subject to codes of conduct enshrined in the applicable strata legislation. For example, in Queensland, strata managers are bound by the 'Code of conduct for body corporate managers and caretaking service contractors' contained in the *Body Corporate and Community Management Act 1997* (Qld). This code requires that in performing their functions, strata managers 'act honestly, fairly and professionally' and 'in the best interests of the body corporate unless it is unlawful to do so'.[19]

Stakeholder views

5.23 In its submission to the inquiry, the Owners Corporation Network (OCN) expressed concern that body corporates tend to rely on strata managers for financial advice regarding strata insurance. This is despite strata managers not generally being legally licenced to provide such advice:

> Ideally, insurance brokers would be recognised as the independent experts who can properly identify the building's specific needs and answer detailed questions about the alternative product offerings. Unfortunately, committees view SM's as the experts in the management of strata plans so many look to them to assist in selecting their insurance cover. Few

17 *Corporations Act 2001*, para. 942C(2)(f).

18 See *Corporations Act 2001*, para. 912A(1)(aa).

19 See Schedule 2, *Body Corporate and Community Management Act 1997* (Qld).

> committees know the questions to ask, and few SM's are qualified legally to give Personal Advice.[20]

5.24 The OCN also suggested that insurance commissions are a disincentive for strata managers to act in the best interests of body corporates when arranging insurance, and that this represents a 'clear conflict of interest':

> And those [strata managers]—the vast majority—who receive a commission for dealing and arranging insurances have a clear conflict of interest, and a disincentive to increase the excess to reduce the premium.[21]

5.25 Moreover, the OCN submitted that 'disclosure, as required by law, is not common', and that limited experience and expertise among body corporates can result in a lack of awareness regarding commissions:

> In reality, many committees, comprised of unskilled volunteers from all walks of life, simply do not have the interest, time, expertise or experience to master the strata insurance product offerings. Committees therefore tend to rely on their SM's for advice without realising that the SM may receive commissions and therefore may not be truly independent.[22]

5.26 Mrs Margaret Shaw echoed these concerns, also noting that body corporate members are not informed of the extent of insurance commissions paid to strata managers:

> In your management agreement with your body corporate manager, you quite often get a section that says if they arrange insurance with you via certain insurance companies or certain brokers they will get five to 20 per cent commission. When it is actually arranged, you do not know if you have paid five or 20 per cent…They are not brokers. They do not have a licence from ASIC, but, because they are getting a commission from the insurance company, I feel that they are acting as an agent on behalf of that insurance company and not necessarily in the best interests of their clients. It is a conflict of interest. Are they going to get quotes from insurance companies that do not pay them a commission? No, they are not.[23]

5.27 When questioned by the committee about evidence suggesting the existence of commission payments directly from insurance companies to strata managers, representatives from IAG advised that:

> That would only occur as a commission payment as part of a distribution agreement, which would be covered by the Financial Services Guide and an expectation, as part of that agreement, that that needs to be disclosed to the

---

20 Owners Corporation Network, *Submission 12*, p. 2.

21 Owners Corporation Network, *Submission 12*, p. 2.

22 Owners Corporation Network, *Submission 12*, pp. 2-3.

23 Mrs Margaret Shaw, private capacity, *Proof Committee Hansard*, 13 April 2017, p. 14.

> body corporate. So that is in not in any way hidden; it is quite upfront and overt to the body corporate.[24]

5.28 In its response to questions taken on notice, the ICA emphasised that 'commissions are legitimately and legally paid to distribute product offerings, a service which needs to be paid for whether by the insurer or otherwise'.[25]

5.29 The ICA also made the point that insurance commissions compensate strata managers for functions performed on behalf of a body corporate, further contending that:

> In the absence of such commission payments, these functions would (contractually) still need to be performed by the strata manager and remunerated, for example if not commissions, possibly by strata fee increases.[26]

5.30 With regard to disclosure practices around commission payments, Allianz informed the committee that:

> It is also standard practice—in the case of underwriting agencies—to include details of commission amounts payable to strata managers on insurance quotations and other insurance schedule documentation, which is addressed to the body corporate.[27]

5.31 However, Allianz also acknowledged that 'there is still room for improvement in the industry in terms of disclosure' and that this 'may also account for some of the ongoing perceptions about lack of transparency on insurance commissions'. Allianz suggested that:

> A simple solution to this perception would be to enforce a requirement for all insurance intermediaries to provide 'dollar-value' information on insurance quotations—that is, at or before the time the decision is made by the body corporate to select a particular insurer—not only after the decision has already been made. Ideally this information would display each component of the total price payable by the body corporate as a separate line item—including amounts attributable to base premium, taxes and levies, commissions payable to strata managers and/or insurance brokers, and broker fees. Such a sensible, common-sense and targeted reform initiative should be easy for insurance intermediaries to implement, and would immediately improve consumer outcomes in terms of disclosure and transparency around product pricing.[28]

---

24 Mr Andrew Ziolkowski, Executive General Manager, Underwriting, Australian Business Division, IAG, *Proof Committee Hansard*, 12 April 2017, p. 40.

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

26 Insurance Council of Australia, answers to questions on notice, 12 April 2017 (received 5 May 2017). See also Allianz, answers to questions on notice, 12 April 2017 (received 4 May 2017).

27 Allianz, answers to questions on notice, 12 April 2017 (received 4 May 2017).

28 Allianz, answers to questions on notice, 12 April 2017 (received 4 May 2017).

5.32 Noting that strata insurance is a state mandated product, some inquiry participants suggested that state and territory governments are best placed to force better disclosure around the financial incentives strata managers receive. QBE noted that New South Wales has recently implemented legislation in this regard,[29] indicating that this could provide a possible template for reform in other state and territory jurisdictions.[30]

Committee view

5.33 The committee is concerned that the current disclosure requirements relating to the payment of insurance commissions to strata managers are insufficient and do not provide adequate transparency to body corporate members. The committee notes that it did not receive any specific evidence to suggest that strata managers are not complying with disclosure legislation. However, given the significant growth of strata as a form of property ownership in Australia, the committee believes that regulatory change to improve transparency on insurance commissions is justified.

Recommendation 12

5.34 The committee recommends that the government strongly consider introducing legislation to require all insurance intermediaries disclose component pricing, including commissions payable to strata managers, on strata insurance quotations.

Recommendation 13

5.35 The committee recommends that state and territory governments strengthen disclosure requirements in relation to the payment of commissions to strata managers.

The role of mitigation

5.36 As discussed in chapter 2, recent increases in premiums for home and strata insurance have largely been driven by the rising claims costs associated with increased incidence of natural catastrophes. In relation to this, some industry stakeholders argued that investment in disaster mitigation is the only way to sustainably reduce insurance premiums over the long term.[31]

5.37 Mr Whelan from the ICA noted the recent destruction caused by Cyclone Debbie and contended that it is catastrophe events such as these that highlight 'the case for urgent investment in permanent, well-designed mitigation for disaster-prone communities'. Mr Whelan further commented that:

---

29 See *Strata Schemes Management Act 2015* (NSW), s. 60.

30 Mr Andrew Broughton, Executive General Manager, Corporate Partners and Direct, QBE Insurance Australia and New Zealand, *Proof Committee Hansard*, 12 April 2017, pp. 53-54.

31 See, for example, Suncorp, *Submission 14*, p. 21; Mr Rob Whelan, Executive Director and Chief Executive Officer, Insurance Council of Australia, *Proof Committee Hansard*, 12 April 2017, p. 27.

> When mitigation does not exist or poor decisions remain about the design, floods have proved devastating. Insurers have to price to risk where these events occur and, where the risk is high, so too are the premiums. In some respects, insurance is the canary in the coalmine. Premiums alert individuals and governments about high risk and low risk of living in certain areas. These signals should spur action in the form of mitigation and resilience measures and better town planning to prevent inappropriate development and improvements to building codes.[32]

5.38 Representatives from IAG expressed a similar view:

> Every time there is a natural disaster it highlights the need for mitigation funding to protect life, property and the Australian economy, and we have been advocating for some time that there needs to be a different approach to natural disaster funding, with more focus on upfront mitigation to avoid some of the impacts we are seeing, including from the most recent devastation caused by Cyclone Debbie.[33]

5.39 Following a significant number of natural disasters between 2009 and 2014, the government requested that the Productivity Commission (PC) undertake an inquiry into National Disaster Funding Arrangements. One of the central terms of reference for the PC's inquiry was to identify:

> Options to achieve an effective and sustainable balance of natural disaster recovery and mitigation expenditure to build the resilience of communities, including through improved risk assessments. The options should assess the relationship between improved mitigation and the cost of general insurance.[34]

5.40 In its final report to government, released in May 2015, the PC noted that insurance is an important risk management option in regards to natural disasters, specifically stating that:

> Insurance markets in Australia for natural disaster risk are generally working well, and pricing is increasingly risk reflective. Insurers can and should do more to inform households on their insurance policies, the natural hazards they face and the indicative costs of rebuilding after a natural disaster.[35]

5.41 However, the PC also found that:

> Governments overinvest in post disaster reconstruction and underinvest in mitigation that would limit the impact of natural disasters in the first place.

---

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

33 Mr Anthony Justice, Chief Executive, Australian Consumer Division, IAG, *Proof Committee Hansard*, 12 April 2017, p. 37.

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

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

> As such, natural disaster costs have become a growing, unfunded liability for governments.[36]

5.42 While responsibility for managing the risks associated with natural disasters lies with state and local governments, the bulk of funding for disaster relief invariably comes back to the Australian Government. The PC found that the cost-sharing funding arrangements (federal to state) 'matter because they impact the incentives to manage risks' appropriately,[37] also noting that 'some natural disasters are unforeseen and their impacts are unavoidable, but in many cases the consequences of natural disasters can be mitigated'.[38]

5.43 The PC recommended, among other things, that:

> Australian Government post disaster support to state and territory governments (states) should be reduced, and support for mitigation increased. Greater budget transparency and some provisioning is also needed.
>
> - States need to shoulder a greater share of natural disaster recovery costs to sharpen incentives to manage, mitigate and insure against these risks. The Australian Government should provide a base level of support to states commensurate with relative fiscal capacity and the original 'safety net' objective of disaster recovery funding, with the option for states to purchase 'top up' fiscal support.
> - Australian Government mitigation funding to states should increase to $200 million a year and be matched by the states.
> - These reforms would give state and local governments autonomy in how they pursue disaster recovery and mitigation. The reforms should be supported by performance and process based accountability mechanisms that embed good risk management.[39]

5.44 The ICA expressed its disappointment in the Australian Government's response to the PC's inquiry, noting that the government did not take up the recommendation to increase mitigation funding to $200 million per year, matched by the states and territories.[40]

---

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

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

38 Productivity Commission, *Natural Disaster Funding Arrangements—Inquiry Report*, Vol. 1, December 2014, p. 3.

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

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

5.45 When questioned by the committee about the correlation between disaster mitigation and reductions in insurance premiums, Mr Whelan provided the following example:

> The best guarantee I can give you is an actual case study of where that has occurred. Roma in Queensland is highly subject to floods. It flooded I think five times in the last six or seven years, devastatingly so—for community and growth as well—and it was subject to very high premiums to the point where a number of insurers were thinking very hard about whether they could maintain a product there. The council in their wisdom decided to act on it, and with some assistance in funding they were able to build a levee. After the completion of that levee and some review of the statistics on the flood risk, which we were then able to calculate into underwriting risk, the premiums in some parts of that area decreased by over 90 per cent. So the facts are that where you reduce the risk the premiums will follow, because it is that equation. The premiums must reflect the risk. If you are able to reduce the risk, we are able to reduce the premiums.[41]

5.46 However, the disproportionate spending between mitigation and post-disaster expenditure remains unchanged since the PC's final report. Federal mitigation spending was approximately three per cent of post-disaster expenditure in recent years.[42] The PC noted that 'the reform imperative is greatest for states most exposed to natural disaster risk, like Queensland'.[43]

Committee view

5.47 In the aftermath of the recent devastation caused by Cyclone Debbie, the committee acknowledges that some disasters are unforeseen and their impacts unavoidable. However, in many cases the consequences of natural disasters can be mitigated. Accordingly, the committee believes that there is an urgent need for governments at the Council of Australian Governments to address investment in targeted disaster mitigation. As well as the obvious benefits mitigation provides with regard to protecting life and property, the committee agrees with industry stakeholders that increased investment in well-designed mitigation by all governments should help reduce home and strata insurance premiums over the long term.

Recommendation 14

5.48 The committee recommends that the Australian Government reconsider its response to the Productivity Commission's inquiry on National Disaster Funding Arrangements.

---

41 Mr Rob Whelan, Executive Director and Chief Executive Officer, Insurance Council of Australia, *Proof Committee Hansard*, 12 April 2017, p. 30.

42 Productivity Commission, *Natural Disaster Funding Arrangements—Inquiry Report*, Vol. 1, December 2014, p. 9.

43 Productivity Commission, *Natural Disaster Funding Arrangements—Inquiry Report*, Vol. 1, December 2014, p. 127.

Recommendation 15

5.49 The committee recommends that, as a matter of urgency, the Australian Government work with states and territories through the Council of Australian Governments to reform national disaster funding arrangements.

Senator Chris Ketter
Chair