
Regulation impact statement

KEY FACT SHEET FOR HOME BUILDING AND HOME CONTENTS INSURANCE POLICIES

Background

1.1 In recent times there has been a significant increase in natural disasters. In 2009, the Black Saturday Bushfires spread across over 450,000 hectares in Victoria. In 2010-2011, areas of Queensland, New South Wales and Victoria all experienced severe flooding. Queensland also suffered the effects of Cyclone Yasi.

1.2 A substantial proportion of the cost of losses resulting from natural disasters is met by insurance. On 28 June 2011, the Insurance Council of Australia (ICA) indicated that, in relation to the Queensland floods and Cyclone Yasi, in excess of 99 per cent of claims had been assessed and determined. ICA member companies had received an estimated \$3.64 billion in claims, with 68,300 claims due to Cyclone Yasi, and 56,200 due to the 2011 Queensland flood event.¹

1.3 These catastrophic events highlight the importance of insurance and making sure that individuals, families, communities and governments have effective insurance cover in place to guard against and recover from disasters.

1.4 In particular, these recent events have shown the extent of underinsurance, with up to half of the homeowners and many businesses affected by the floods being underinsured² and the difficulties faced by people affected by natural disasters that do not have insurance or do not have the right type of insurance.

1.5 The recent events have also highlighted that there may be some confusion around flood insurance and what is covered when a flood occurs within the community.³ A number of households have suffered

1 ICA, 'Insurance Claim Payments on the Increase', media release, 28 June 2011

2 Insurance News.com.au, 'fortnightly premiums payments - why not'
<http://www.insurancenews.com.au/analysis/fortnightly-premium-payments-why-not>

3 JVIB News 'Time for a change – calls to review 'flood' definitions'

hardship as a result of underinsurance and in some cases no insurance, for the flood event.

1.6 On 4 March 2011, in response to the escalating number of natural disasters, the Hon Bill Shorten, MP Assistant Treasurer and Minister for Financial Services and Superannuation announced an independent review into disaster insurance in Australia. The Natural Disaster Insurance Review (NDIR)⁴ has been tasked with looking at the broad issues relating to insurance in the context of the long term funding of disaster relief. Issues such as affordability and availability of flood insurance are being addressed by the NDIR and are outside the scope of this Regulation Impact Statement (RIS).

1.7 On 5 April 2011, as a first step in reforming flood insurance, the Hon Bill Shorten, MP Assistant Treasurer and Minister for Financial Services and Superannuation released a consultation paper 'Reforming flood insurance — Clearing the waters'.⁵ The consultation paper was released to engage the community on some particular suggestions for improving the regulatory framework for flood insurance and other aspects of Australia's insurance market.

1.8 The consultation paper contained two key proposals designed to improve clarity for consumers in relation to insurance policies and in particular, the cover provided for various types of flood, these include a standard definition of a flood and a Key Facts Sheet (KFS), which would outline the key information in relation to Home Building, Home Contents and Home and Contents insurance policies (HBHC). This RIS covers the KFS proposal.

1.9 On 2 June 2011 the Standing Committee on Social Policy and Legal Affairs⁶ commenced an inquiry into, and report on, the operation of the insurance industry with specific reference to extreme weather and disaster events.

1.10 In addition to the actions of the Commonwealth Government (the Commonwealth) the Victorian and Queensland governments have also responded to the recent natural disasters with the establishment of the Review of the 2010-2011 Flood Warnings and Response⁷ in Victoria and

4 The terms of reference of the NDIR can be found on the National Disaster Insurance Review website: <http://www.ndir.gov.au>

5 The 'Reforming flood insurance: Clearing the waters' consultation paper can be found at: <http://www.treasury.gov.au/contentitem.asp?ContentID=2039&NavID=037Archive>

6 Standing Committee on Social Policy and Legal Affairs website: <http://www.aph.gov.au/house/committee/spla>

7 Information on the review can be found at: <http://www.floodsreview.vic.gov.au>

the Independent Commission of Inquiry into Queensland floods in Queensland.⁸

Current Regulation

Pre-contractual disclosure

1.11 The key laws governing pre-contractual disclosure for insurance are:

- the ‘standard cover’ rules in section 35 of the IC Act for certain types of prescribed household/personal contracts; and
- Product Disclosure Statement (PDS) rules for retail customers (under the *Corporations Act 2001* (Corporations Act)).

Section 35 of the Insurance Contracts Act 1984 — standard cover

1.12 Section 35 of the IC Act provides that standard cover (that is, minimum levels of cover for prescribed events) will be deemed to be included in certain classes of prescribed insurance policies, including home buildings insurance and home contents insurance (other than cover notes and renewals). The standard cover terms and conditions are set out in the *Insurance Contracts Regulations 1985* (ICR).

1.13 By way of example, the Regulations state that standard cover in respect of home contents insurance includes loss that is:

... caused by or results from — ... storm, tempest, flood, the action of the sea, high water, tsunami, erosion or landslide or subsidence ...

1.14 If an insurer seeks to limit or exclude its liability in respect of the standard cover, then the insurer must prove that:

- it ‘clearly informed’ the consumer of the limitation or exclusion in writing before the contract was entered into (or within 14 days if provision before the contract was not reasonably practicable, e.g. telephone sales); or
- the consumer knew of the limitation or exclusion; or
- a reasonable consumer in the circumstances could be expected to have known of the limitation or exclusion.

8 Information on the Commission can be found at: <http://www.floodcommission.qld.gov.au>

1.15 If the insurer is unable to prove anyone of these three conditions, then the insurer will be liable to make good any losses suffered by a consumer that were caused by, or resulted from, any of the standard events (construed in accordance with their ordinary meanings) up to a maximum limit (usually \$2 million).

1.16 There have been a number of court and dispute resolution cases in relation to the interpretation of ‘clearly inform’, which illustrate that although there could be various means to inform, provision to the insured of a policy document containing exclusions is sufficient, unless there are exceptional circumstances (for example, if the provisions in the policy are particularly confusing or complex). The court decision most cited on this issue *Hams & Ors v CGU Insurance Limited [2002] NSWSC 273* (Hams) includes the following passage:

‘a fair reading of s35(2) does not warrant the conclusion that the result need go further than to provide for the relevant exclusion in the policy wording in clear and unambiguous language and in a manner which a person of average intelligence and education is likely to have little difficulty in finding and understanding if that person reads the policy in question’.⁹

1.17 In practice, the standard cover regulations are often rendered non-applicable by the provision to the insured of a policy document (usually contained within a PDS), thereby satisfying the requirement to ‘clearly inform’ the consumer. In a case where such a policy document was provided, the protection offered by section 35 would only be available if the terms in the policy were particularly complex or confusing.

1.18 A common view held by consumer groups¹⁰ is that a large proportion of policy holders do not read in detail the policy documents they receive from their insurers so the protection offered by section 35 is not, in practice, a very effective tool to ensure that consumers are informed about their cover.

Chapter 7 of the Corporations Act 2001 — Financial services disclosure

1.19 Chapter 7 of the Corporations Act provides that clients are required to be issued a PDS when committing to a policy. The key criterion for this obligation to apply in relation to general insurance

9 *Hams & Ors v CGU Insurance Limited [2002] NSWSC 273*

10 Joint submission to Reforming Flood Insurance: Clearing the Waters discussion paper, 13 May 2011, http://www.legalaid.vic.gov.au/xfw/rc_Joint_Submission_-_Reforming_Flood_Insurance_-_May_2011.pdf

products is that the client is a retail client, as defined in section 761G of the Corporations Act. Section 761G provides that :

- the acquirer of the product must be either an individual or a small business (fewer than 20 employees or 100 for manufacturing businesses); and
- the insurance product is within one of the following classes of insurance prescribed by the legislation and as defined in the regulations:
 - motor vehicle insurance;
 - home building insurance;
 - home contents insurance;
 - sickness and accident insurance;
 - consumer credit insurance;
 - travel insurance;
 - personal and domestic property insurance; or
 - another kind of general insurance product prescribed in the regulations (currently including medical indemnity insurance).

1.20 In general terms the PDS requirements apply to contracts prescribed for standard cover purposes under the IC Act, and some other classes of insurance.

1.21 Corporations Regulation 7.9.15E requires a PDS for a retail insurance product to contain both the policy terms (other than the policy schedule), and any information that would be required under sections 35 and 37 of the IC Act.

1.22 A consequence of this requirement is that, for those general insurance products subject to PDS requirements, the ‘clearly inform’ requirements in sections 35 and 37 of the IC Act are supplemented by a ‘clear, concise and effective’ requirement which applies generally under the Corporations Act to material in PDS documents.

Additional Comments on Current Financial Product Disclosure

1.23 In general, under the Corporations Act, a retail client must receive a PDS before acquiring a financial product. The PDS document sets out the significant features of a financial product, including its risks, benefits and cost.

1.24 The broad objectives of a PDS are to help consumers compare and make informed choices about financial products. To achieve these objectives, the legislation requires that all information contained in a PDS must be worded and presented in a clear, concise and effective manner. While ensuring increased disclosure for retail investors the requirements regarding the format of PDS are considerably flexible. This flexibility can however lead to significant increases in the size and complexity of PDSs.

1.25 In order to overcome the adverse outcomes that may arise as a result of this flexibility, providers of simple financial products are required to issue shorter PDSs. The shorter PDS regime currently applies to First Home Saver Accounts, margin loans and from 23 June 2011 will apply to simple Managed Investment Schemes (MIS) and superannuation products. However, it does not apply to general insurance policies. The shorter PDS regime has been introduced to ensure that key information is provided in clear way to allow retail investors to make effective financial decisions. The shorter PDS regime uses an ‘incorporated by reference’ mechanism to ensure that all additional information to the key information provided in the shorter PDS is provided when or where required.

1.26 More recently, a single page format for providing consumers with key information has been considered to be an appropriate way of ensuring that retail investors are able to make more informed and timely financial decisions. Although concerns have been raised that a new single page document outlining the key information in respect to a financial product or service could be taken as a substitute for a more comprehensive form of disclosure (a PDS or a shorter PDS), both industry and consumer groups see the merit in the single page format.¹¹

The problem

Summary

1.27 Currently, some consumers may find it difficult to easily access key information within their insurance policies. This may lead to some confusion in relation to what is and what is not covered under HBHC insurance. In this regard, the PDS rules for general insurance, as currently implemented, may not be as effective as they could be for informing

11 Insurers back flood definition but wary of ‘key facts’,
<http://www.insurancenews.com.au/local/insurers-back-flood-definition-but-wary-of-key-facts>

consumers about HBHC insurance policies, and enabling comparisons between these policies.

1.28 If key information about policies is not readily accessible to consumers, there is potentially a greater risk of consumers acquiring insurance that does not fully match their requirements. This may result in consumers facing adverse outcomes when seeking to claim the replacement of, or financial remuneration for, property damaged as a result of unforeseen events.

1.29 It should be noted that there are a number of uncertainties surrounding the identification and magnitude of the problem due to the lack of data.

Current situation

Confusion/uncertainty surrounding insurance created due to the lack of accessibility of information

1.30 The difficulty in accessing key information regarding HBHC policies may cause confusion and uncertainty.

1.31 Due to the lack of empirical research into consumer understanding and confusion in respect to financial products the potential magnitude of the impact of consumer confusion cannot be fully captured at this time. However, one area where reliable data has been collected is on disputed claims.

1.32 It is important to note that the data provided in relation to disputed claims should be only seen as one part of the potential overall magnitude of the potential problem.

1.33 In Australia, most financial service providers have their external disputes resolved by the Financial Ombudsman Services (FOS). FOS's independent dispute resolution processes covers complaints about financial services including general insurance¹², life insurance and FOS is an independent, national body which offers an information service for consumers on general insurance as well as providing free help to consumers who have disputes with their general insurance providers.

¹² General insurers in Australia also operate under a code of practice that is monitored by the Financial Ombudsman Service (FOS). Under the code of practice insurers have 10 business days from lodgement of all required claims materials in which to communicate an initial assessment of your claim. There are options under the code of practice for consumers if this timeline is not met.

1.34 Prior to its merger with Banking and Financial Services Ombudsman and Financial Industry Complaints Service to form FOS in 2008 the Insurance Ombudsman Service (IOS) provided the independent dispute resolution processes for disputes of general insurance policies.

1.35 In the General Insurance Code of Practice: Overview of the 2007-2008 Financial Year¹³, which is released by the IOS, statistical data is provided on its internal dispute resolution monitoring of both new business and renewals (refer table 4.1).

1.36 In this regard, the data in relation to home building and contents insurance policies, which are combined under the heading of total home in the table 4.1 below, for the 2007-2008 financial year indicates that there were 11,363,851 new business and renewals of HBHC insurance policies. Of the new and renewed insurance policies a total number of 1,029,971 claims were made. The data indicates that of the 1,029,971 claims made 33,672 were rejected by members.

1.37 The total number of new business and renewal HBHC insurance policies represent, 36.27 per cent of the entire number of personal insurance policies in the general insurance market. This figure indicates the importance consumers place on ensuring they have HBHC insurance cover when looking at other types of general insurance policies.

1.38 Claims made in relation HBHC make up 32.47 per cent of the entire number of claims across the personal insurance policy market, thus indicating that consumers are likely to depend more on insurance cover for their HBHC needs than for other types of general insurance policies. However, motor vehicle insurance has percentages equivalent to those of HBHC insurance policies.

1.39 There were 4312 insurance claims made in relation to HBHC policies taken to internal dispute resolution which represented 73.41 per cent of the total disputes taken to internal dispute resolution. Buying insurance was the next most common reason with employee, code and catastrophe/disaster issues representing only a small proportion of the overall reasons.

13 General Insurance Code of Practice: Overview of the 2007-2008 Financial Year can be found at:
http://www.fos.org.au/centric/home_page/publications/general_insurance_code_of_practice_yearly_overview.jsp

Table 1.1 General Insurance Code of Practice: New business & renewals, claims and rejected claims statistics

	Total New Business & Renewals (in force as 20/08/2008)	Total Claims	Total Rejected Claims	Internal Disputes						Total Received	Disputes found in Favour of Code Member	Disputes found in Favour of Customer	Total Received Disputes
				1	2	3	4	5	6				
				Authorised Representatives	Employees	Buying	Insurance Claims	Responding to Catastrophes & Disasters	Other Relating to Code				
Totals													
Grand Total for Personal & Commercial	36,092,906	3,675,105	78,306	20	630	3,343	14,706	100	179	18,978	11,929	7,115	19,044
Total Personal	31,334,975	3,172,539	69,433	14	619	3,300	13,768	100	172	17,973	11,274	6,783	18,057
Total Commercial	4,757,931	502,566	8,873	6	11	43	938	0	7	1,005	655	332	987
Personal Classes													
Total Motor	11,602,411	1,600,237	9,212	6	344	2,077	6,144	5	73	8,649	5,382	3,322	8,704
Total Home	11,363,851	1,029,971	33,672	6	254	1,120	4,312	93	89	5,874	3,992	1,858	5,850
Travel Personal	3,505,105	189,922	16,208	1	7	39	2,369	0	3	2,419	1,244	1,261	2,485
Consumer Credit	926,455	21,325	3,606	0	0	7	60	0	0	67	46	20	66
Total Sickness	417,185	54,082	622	1	0	3	200	0	0	204	118	76	194
Total Valuables	925,881	42,510	2,090	0	0	3	54	0	4	61	47	17	64
Pleasure craft	323,925	10,930	172	0	0	3	80	0	0	83	31	24	75

1.40 In the IOS 2007-2008 Annual Report¹⁴, the IOS provided statistical information regarding consumer disputes. The following tables, which have been taken from that report, provide some additional insight into potential issues regarding HBHC insurance policies.

14 Insurance Ombudsman Services (IOS) 2007-2008 Annual Report can be found at: http://www.fos.org.au/centric/home_page/publications/annual_reports_archive.jsp

Table 1.2 Reasons why member denied liability

	Cancel of insurance contract	Disclose issues	Exclusion/Condition	Failure to offer insurance	Fraudulent Claim	GI product advice	No policy contract	No proof of loss	Non-disclosure on proposal	Not covered by policy	Other	Premium & no claims bonus changes	Quantum	Sales & Marketing	Service/handling of compl	Third party	Total	2007-2008	2006-2007	
Risks	0	0	1	0	1	0	0	0	0	0	0	0	0	0	0	0	0	2	0	1
Caravan/Campervan	0	0	6	0	0	0	0	0	0	0	0	0	0	3	0	0	0	9	0.4	0
Consumer	0	0	8	0	0	0	0	0	0	0	0	0	0	0	0	1	0	9	0.4	1
Home Buildings	5	1	476	1	5	0	11	0	7	38	0	2	54	1	3	0	604	28	21	
Home Contents	0	0	148	1	8	0	2	1	5	24	0	0	31	0	1	0	221	10	12	
Marine-Pleasure	0	1	9	1	0	0	0	0	1	0	0	0	0	0	0	0	0	12	0.6	1
Medical Industry	2	0	2	0	0	0	0	0	0	0	0	2	0	0	0	0	0	6	0	0
Motor Vehicle TP	5	9	324	4	101	1	59	0	82	8	0	8	88	2	12	0	703	32	35	
Other	0	0	8	0	0	0	0	0	0	0	0	2	1	0	0	0	11	0.5	0	
Personal Activity/Sickness	0	1	75	0	0	0	1	0	2	2	0	0	1	2	0	0	84	4	4	
Small Business	1	1	62	0	0	0	1	0	1	4	0	0	11	0	0	0	81	4	3	
Strata Title	0	0	25	0	0	1	0	0	0	0	0	0	1	0	0	0	27	1	2	
Travel	0	0	335	3	4	0	4	0	0	3	1	1	7	0	2	0	360	16.5	18	
Total	13	13	1481	10	119	2	78	1	98	79	1	15	200	5	20	35	2170	100	100	
Percentage	1	1	68	0	5	0	4	0	5	4	0	1	9	0	1	2	100			

1.41 When considering the data in table 4.2 (Reasons why member denied liability) exclusions/conditions was the main area of contention/dispute with 478 of the 604 claims for home buildings and 148 of the 221 claims for home contents being rejected. This represented 75.88 per cent of all of the areas of where members denied liability. The other two main areas of contention, but to a significantly lesser extent, can be seen to be disputed over what is not covered by the policy and quantum of the claim/payout.

1.42 Although there is no available data regarding the particular issues surrounding the reasons why members denied liability, anecdotal evidence¹⁵ suggests that the main reasons were due to the fact that the insureds had thought they had a basis for making the claim.

Table 1.3 Summary of outcomes by policy type

	In favour of applicant		In favour of member		Settled		Rejected		Withdrawn by applicant		Supp det. case		Total
		per cent		per cent		per cent		per cent		per cent		per cent	
All Risks	0	0	1	50	0	0	1	50	0	0	0	0	2
Caravan/ Campervan	2	33	4	66	0	0	0	0	0	0	0	0	6
Consumer Credit	1	9	8	72	2	0	0	0	0	0	0	0	11
Home Buildings	140	26	324	60	68	12	2	0	0	0	4	0	538
Home Contents	40	18	138	65	29	13	3	1	1	0	0	0	211
Marine-Pleasure craft	2	16	8	66	2	16	0	0	0	0	0	0	12
Medical Industry	1	50	1	50	0	0	0	0	0	0	0	0	2
Motor Vehicle	192	28	379	55	93	13	17	0	2	0	0	0	683
Motor Vehicle TP	14	36	20	52	4	10	0	0	0	0	0	0	38
Other	3	20	9	60	3	20	0	0	0	0	0	0	15
Personal Activity/ Sickness	32	41	30	38	15	19	0	0	0	0	0	0	77
Small Business	24	34	39	55	6	8	0	0	0	0	1	0	70
Strata Title	7	35	8	40	5	25	0	0	0	0	0	0	20
Travel	77	21	217	61	57	16	2	0	0	0	0	0	353
Total	535	26	1,186	58	284	13	25	1	3	1	5	0	2,038

1.43 Table 4.3 (Summary of outcomes by policy type) clearly shows that the vast number of the disputes referred to the IOS are found in the favour of the insurers. In this regard only 26 per cent of consumer in respect of home buildings and only 18 per cent of consumer in respect of home contents were found in the favour of the consumer (applicant).

1.44 Although there is no available data on the exact reasons why consumers referred disputes to the IOS, it is considered that there is a high likelihood that they were of belief that they have a legitimate basis for doing so. The IOS data suggests that consumers are incorrect in this belief.

1.45 In summary, the data from the IOS demonstrates that:

- only a small number of consumers make insurance claims in relation to the number of overall consumers holding HBHC insurance policies;
- of all of the claims made only a small number were rejected;
- HBHC and Motor Vehicles are two areas where insurance policies appear are most common and the areas in which most claims are made;
- insurance claims are the most likely reason why disputes are taken to internal dispute resolution;

- the main area of contention where members denied liability was that of exclusions/conditions; and
- most but not all disputes referred to the IOS are found in favour of insurers, even though it would be assumed that consumers believed that their disputes were justified on the basis that they believed they were covered for the claims they were making.

While there may be a problem in relation to confusion in HBHC insurance policies, particularly around exclusions/condition, the problem may be seen to be small in absolute terms when considering claims where external dispute resolution has taken place.

1.46 As stated in paragraph 4.31 above data in relation to consumer understanding and confusion in respect to financial products and the potential magnitude of the confusion cannot be fully captured at this time.

1.47 It is important to note that the nature of insurance is to protect consumers from incurring a loss when an unforeseen future event occurs. It is only possible to establish the extent/magnitude of any problems regarding confusion when an unforeseen event occurs. Therefore any issues for consumers regarding confusion that exist outside the context of unforeseen events are generally not able to be identified or reliably measured.

Home Building and Home and Contents

1.48 In order to ensure consumers are informed regarding HBHC insurance policies, consumers should read the policy's PDS, or at least be familiar with the key information contained in the PDS.

1.49 However, as discussed in Australian Securities and Investment Commission's March 2011 report 'Financial literacy and behavioural change'¹⁶, consumers are often overwhelmed by the sheer volume and complexity of investment information available to them, including disclosure material such as PDSs. The increasing length and complexity of PDSs is also becoming a considerable obstacle for consumers when making their financial decisions.

1.50 When consumers are informed at the time of making their insurance decisions they are more likely to secure the correct amount of

16 Report 230 'Financial literacy and behavioural change' released March 2011, <http://www.financialliteracy.gov.au/media/218309/financial-literacy-and-behavioural-change.pdf>

cover. In an unpublished presentation to the Insurance Council, in 2010, Inside Story presented their research findings into the insurance product information needs of consumers. This research¹⁷ examined the level of consumer understanding of PDSs for both motor vehicle and HBHC insurance policies.

1.51 As part of their research Inside Story examined the way consumers used or failed to use PDSs both before and after purchasing an insurance policy. In this regard:

- 49 per cent of respondents indicated that they had never read a PDS document before taking out a motor vehicle or HBHC insurance policy. Of the respondents that had read a PDS before entering into a policy, 5 per cent read the first few pages only, 46 per cent went straight to particular sections, 30 per cent flicked through the majority of the document and 19 per cent read most or all of the PDS.
- 32 per cent of the respondents indicated that they had not referred to a PDS document after taking out a motor vehicle or HBHC insurance policy. Of the respondents that had referred to a PDS after entering into a policy, 6 per cent read the first few pages only, 43 per cent went straight to particular sections, 36 per cent flicked through the majority of the document and 15 per cent read most or all of the PDS.

1.52 These findings indicate that a number of consumers fail to recognise the importance of reading their PDS or at least being aware of the key information regarding their HBHC insurance policies both before and after their purchase.

1.53 The issues surrounding the availability of information in, and the useability of, PDSs have been highlighted in recent assessments regarding the introduction of a shorter form PDS for a number of simple financial products, such as the First Home Savers Account and the introduction of a KFS for home loans.

1.54 The supporting material to the *Corporations Amendments Regulations 2010 (No. 5)*¹⁸ states that:

17 Inside Story, 2010, an unpublished presentation to the ICA, 'Consumer Insurance Product Information Needs' project number 3259.

18 The supporting material to the *Corporations Amendments Regulations 2010 (No. 5)* is the Regulation Impact Statement (RIS) for the introduction of the shorter PDS regulations for superannuation products and MIS, which satisfied OPBR RIS requirements. A copy of the supporting material to the *Corporations Amendments Regulations 2010 (No. 5)* may be found at: www.comlaw.gov.au/Details/F2010L01585/Supporting%20Material/Text

‘In recent years, there has been considerable discussion about the overall effectiveness of current PDSs. A particular concern is that the effectiveness of disclosure has been compromised by a tendency for suppliers of financial products to provide excessive information, generally over and above what the reasonable consumer would need to make a product purchasing decision. Disclosure documents can vary significantly in their length, design and structure.’

1.55 In chapter 6 of the explanatory memorandum¹⁹ to the National Consumer Credit Protection Amendment (Home Loans and Credit Cards) Bill 2011 states that:

‘studies also show that lengthy precontractual disclosure documents do not assist consumers and instead overloads them with information Consumers generally focus on the headline information, such as amount repayable each month, interest rates and whether insurance is required’

1.56 The inability for consumers to easily access key information can be seen to be leading to increased levels of confusion, which in turn, is leading to inappropriate decisions being made.

1.57 Confusion can be seen to exist whenever consumers are faced with a large amount of information in relation to a particular decision or action. While researchers currently differ on a precise definition for consumer confusion²⁰, the research indicates that three factors are generally present when consumer confusion occurs. These factors are:

- a perceived similarity in the product or service;
- an overloading of information; and
- ambiguity surrounding the information being presented.

1.58 Research undertaken by Inside Story (as discussed above) revealed that the current level of consumer understanding of PDSs for motor vehicles and HBHC insurance policies was poor at the best.

19 Chapter 6 of the Explanatory Memorandum to the National Consumer Credit Protection Amendment (Home Loans and Credit Cards) Bill 2011 contains that Regulation Impact Statement (RIS). The Office of Best of Best Practice and Regulation indicated that the RIS that was prepared prior to the final decision satisfied their requirements a copy of the RIS can also be found at: <http://www.ris.finance.gov.au/2010/12/21/competitive-and-sustainable-banking-system-%E2%80%93-%E2%80%98key-facts%E2%80%99-document-treasury/>

20 ‘Towards a Conceptual Model of Consumer Confusion’, Vincent-Wayne Mitchell, Gianfranco Walsh and Mo Yamin.

1.59 In this regard, when respondents were asked ‘how easy is it to understand the information in your HBHC insurance policy product disclosure statement’:

- Only 10 per cent indicated that they found that PDSs to be very easy to understand.
- 40 per cent indicated that PDSs were somewhat easy to understand.
- 24 per cent indicated that PDSs were neither easy nor difficult to understand.
- 22 per cent indicated that PDSs were somewhat hard to understand.
- 4 per cent indicated that they found PDSs to be very difficult to understand.

1.60 In response to why PDSs were hard to understand, of the relevant respondents:

- 52 per cent indicated that the use of big words and jargon needed to be simpler.
- 42 per cent indicated that PDSs were too detailed, longwinded and contained too much information.
- 8 per cent indicated that the fine print was confusing, complicated and contradictory.
- 7 per cent indicated that the information contained in PDSs is not clear or understandable.

1.61 When looking at these findings, it is clear that some consumers are not able to access or effectively understand all of the information in PDSs covering HBHC insurance policies. This is particularly the case when looking at the wording and length of PDSs.

1.62 In 2000, the Australian Securities and Investments Commission (ASIC) released a report ‘Consumer understanding of flood insurance’ outlining areas where improvements in disclosure in respect of flood insurance should be made.²¹ The report identified the types of problems faced by consumers, undertook an analysis of the relevant disclosure documentation and reviewed a number of external dispute resolution scheme panel determinations.

21 ASIC, Report 7 ‘Consumer understanding of Flood Insurance’, [http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/floodreport.pdf/\\$file/floodreport.pdf](http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/floodreport.pdf/$file/floodreport.pdf)

Problems faced by consumers

- Consumers often have a limited understanding of the level of flood cover they have in their HBHC insurance policy.
- Consumers are not always aware of the requirement to have additional cover for flood damage as part of their HBHC insurance policy.
- Policy documentation can be confusing and ambiguous in its language with technical meanings often given to common words.
- Consumers are not always aware of the distinction between the types of damage and whether they are covered.
- The assessment of claims for flood damage is often more complex than for other events covered by HBHC insurance policies.

Analysis of the relevant disclosure documentation

- Document format — a policy may be comprised of a number of documents, requiring the consumer to read a number of different documents (including the application, schedules, endorsements, the insurance contract and the Product Disclosure Statement (PDS)).
- Type of policy — the structure of the policy may, in some instances, make it harder for a consumer to work out the extent of their home and contents insurance coverage.
- Definitions and terms — participants in the insurance industry currently use differing definitions for key words, making it harder for consumers to make effective comparisons between HBHC insurance policies. Key terms are not always defined at the start of the relevant policy documentation making it harder for consumers to fully understand their cover.

External resolution scheme panel determinations

- There are examples of the effect of layout and presentation of a document affecting a consumer's ability to understand the terms of the policy:

‘The policy document is somewhat cluttered in its appearance. It explains that flood is excluded from home building cover at page 17 of a 40 page document and at page 21 it explains that contents cover excludes flood. The definition of flood appears at page 8. Whilst an insured’s

attention is not immediately arrested by these references there is nothing confusing about them. The policy is reasonably well indexed. The Panel is thus of the opinion that the policy document satisfies the statutory requirement to clearly inform'.²²

- The effect that prominence given to particular items in a policy document can have on the statutory requirement to clearly inform:

'In this case the reference in the policy to the exclusion of flood first appears at page 13 of the policy document. It is not highlighted and is not particularly prominent. However, the term appears in the definition section and appears under the part of the policy that identifies what is not covered by the policy. The index draws attention to three entries of the term. Although the term could have been more prominently identified within the policy a person looking to see if flood is covered would have no difficulty in finding the answer. In the Panel's opinion, the insurer has satisfied its obligations pursuant to Section 35 of the Act'.²³

1.63 ASIC's report illustrated that whilst from a legal position the statutory requirement to clearly inform may be satisfied, the current requirements under the IC Act and Corporations Act do not address the confusion experienced by consumers when looking at HBHC insurance policies. Recent experience in natural disasters demonstrates that confusion surrounding HBHC insurance policies in this context still exists.

Cooling off period

1.64 Another area of confusion/uncertainty surrounding HBHC insurance policies is that of the cooling off period.

1.65 In order to provide consumers with protection after an HBHC insurance contract is entered into, insurers are required to provide a sufficient time period for the consumer to consider the policy, or have an adequate cooling off period in respect to the policy.

1.66 The cooling off period provides consumers with the time to fully consider their decisions free from any pressure or impulse. This allows consumers to evaluate all of the key information in relation to the particular policy.

22 IEC Determination Referral No 299 047 211

23 IEC Determination Referral No 299 047231

1.67 In essence the cooling off period gives a consumer with the ability to think over the advantages and disadvantages of a policy to ensure they have obtained the appropriate policy for their requirements.

1.68 In an examination of five HBHC insurance providers the length of the cooling off period provided by the particular HBHC insurance policy was found between pages 5 and 47 of the PDS.²⁴

1.69 The qualitative findings of the research undertaken by Inside Story indicate that when taking out car or home insurance 28 per cent of respondents were unaware that there was a legal cooling off period during which time they could cancel their policy at no cost if they were not happy with their decision.

1.70 The remaining 72 per cent of respondents indicated that they were aware there was a legal a cooling off period. However the length of the cooling off was thought to range from 7 to 30 days²⁵ with 25 per cent of respondents correctly identifying the legal cooling off period provided under the Corporations Act of 14 days.

Adverse outcomes arising as a result of confusion/uncertainty

1.71 The main adverse outcomes that can be seen to arise as a result of confusion surrounding HBHC insurance policies are of a financial nature.

1.72 In a recent unpublished report²⁶ into a better PDS regime, it was noted that although, from the industry's perspective, the risk of consumers making poor decisions was relatively small, consumers still make seemingly 'poor' choices in relation to their insurance.

24 On page 21 of NRMA's PDS 'Home Insurance Buildings and Content Product disclosure statement and policy booklet', on page 5 of youi's PDS 'Home Product Disclosure Statement', on page 47 of ANZ's PDS 'ANZ Home Insurance Product Disclosure Statement and Policy Document', on page 7 of CommInsure's PDS 'CommInsure Home Contents Product Disclosure Statement (PDS) and on page 11 Westpac's PDS 'Love is. A hot bath. A good book. Your sofa.' Home and Contents Insurance Product Disclosure Statement and policy wording.

25 Currently the IC Act requires any document required to be provided to the policy holder, to be provided either personally or to the policy holder's postal address. Therefore, although 78 per cent of respondents indicated that they were aware of the legal cooling off period a number of consumers may still be under the belief that if they fail to receive the disclosure documentation for their policy within 7 days, the cooling off period would not be able to be relied upon.

26 The Allen Consulting Group, 2009, unpublished draft report to the ICA 'A better Product Disclosure Statement Regime'

1.73 These poor decisions were generally seen to be made in relation to:

- insufficiencies in the sum insured to cover replacement costs;
- failure to take into account other incidental costs in the sum insured; and
- failure to cover for specific risks such as flood.

1.74 These poor decisions can potentially lead to financial distress/difficulty for the affected consumers in both the short and long term. In this regard, when discussing the recent Queensland floods²⁷, Legal Aid Queensland indicated that many of their clients were unaware that there were limitations to their home insurance cover and did not understand their insurance policies. Some clients discovered that although their claims were accepted, the fine print in their insurance policies limited their pay-outs to capped amounts which represented a decrease in the sum available for re-building.

1.75 It is important to note that when looking at reasons why consumers may make poor decisions in relation to their insurance cover, other factors may also play a role. These include confusion about the policy, poor assessment of their individual risks' and poor assessment of their likely damage in the event of an event occurring.

Current regulation and its effectiveness

1.76 As outlined previously, HBHC insurance policies are regulated by the IC Act. Section 35 of the IC Act prescribes the minimum statutory requirements for the cover provided under the policy, one of which is the provision of flood cover.

1.77 However, insurers are able to derogate from the prescribed minimum terms by offering a lower level of cover provided they 'clearly inform' the derogation to the customer before the consumer commits to the policy.

1.78 In addition to the requirement to 'clearly inform' any derogations under the IC Act, the Corporations Act requires insurers to provide consumers with a PDS for each policy. The PDS is required to contain both the policy terms (other than the policy schedule), and any

²⁷ Legal Aid Queensland, 'Preliminary submission to Queensland Floods Commission of Inquiry re paragraph 2(b) of the Terms of Reference', submission, 4 April 2011

information that would be required under sections 35 and 37²⁸ of the IC Act.

1.79 The insurance provider must also ensure that the consumer has adequate time to read and fully understand the policy before committing, or the provider must have an adequate cooling off period²⁹ in respect to the policy.

1.80 Although there is some standard content for insurance contracts the format of the relevant documentation can vary significantly. These variations can lead to situations where the wording of the documents can be confusing and ambiguous especially when it comes to derogations such as exclusions for specific types of flood or floods in general.

1.81 The requirements for pre-contractual disclosure should help to prevent policyholders being 'surprised' by exclusions or conditions. However, although the current requirements provided under the IC Act and Corporations Act go some of the way to preventing consumers being surprised, gaps still remain evident.

1.82 It is common for consumers to find themselves in situations where they are totally unaware that they are not covered for certain events or are only covered for certain events such as particular types of flood. The practical limitation that can be seen to arise in relation to pre-contractual disclosure has been recently commented on by the Chair of the Claims Review Panel of the then Insurance Ombudsman Service when he remarked that:

'The fundamental principle relevant to all insurance disputation on which all parties agree is that no-one ever reads the policy before a claim is made.'

28 Section 37 of the IC Act relates to the notification of unusual terms. For 'non-prescribed' types of contracts (which would include, for example, commercial buildings and contents), there is no standard cover regime. However, insurers still need to 'clearly inform' policy holders in writing, before a contract is entered into, of the effect of any terms 'of a kind that are not usually included in insurance contracts that provide similar insurance cover'. Failure to clearly inform an insured of such a clause (for example, an unusual exclusion or limitation) means the insurer is not permitted to rely on it later. Section 37 only applies to provisions 'not usually included in contracts of insurance that provide similar cover'. So, if an exclusion or limitation is generally used in relation to the type of cover concerned, section 37 offers no protection even if the insured was not clearly informed of the term.

29 The Cooling off Period for Retail Clients (as defined in the Corporations Act 2001)

Conclusion

1.83 Some consumers may find it difficult to access key information on particular policies. This may be seen to occur cross all types of insurance policies but HBHC insurance policies appear to be of particular concern.

1.84 The key points to note about the problem are that:

- there may be an amount of confusion regarding HBHC insurance products in respect to:
 - the extent of coverage (what is covered);
 - the exclusions that exist (what is not covered); and
 - other technical information such as the cooling off period.
- some consumers may find it hard to access the key information regarding their HBHC insurance policies, as the information contained in the PDSs may not be readily accessible for some consumers.
- the current disclosure requirements for HBHC may not be effective in providing consumers with the information they require in order to make effective decisions regarding their HBHC insurance policies; and
- if consumers make ineffective decisions regarding their insurance needs, adverse outcomes may arise for both the individuals affected and society as a whole.

1.85 While there may appear to be a problem in relation to confusion, the magnitude of the problem cannot be clearly established through empirical evidence. Therefore it must be recognised that, at this time, it is not possible to conclude that any Option considered in this RIS will be able to be seen to address the problem.

Objectives of Commonwealth Government action

1.86 The Commonwealth's aim is to assist consumers with understanding the basic terms of their HBHC insurance policies (combined and separate policies), including the nature of cover and any key exclusions.

Options that may achieve the objectives

1.87 There are many possible options for providing consumer access to key information and addressing confusion surrounding and regarding HBHC insurance policies. However, no option will ever completely solve this problem as there will always be some consumers that fail to fully consider the impact of not taking the steps required to make effective decisions regarding their insurance needs.

1.88 In addition, it is also important to note that as the magnitude and the cause of the problem cannot be clearly established through empirical evidence as discussed in paragraph 4.32 above, it is not possible to conclude that any Option will address the problem and result in a net benefit.

Option A: Maintain the Status Quo

1.89 Maintaining the status quo allows both consumers and industry to continue to make decisions/operate in accordance with the current law. While this option has no cost implications for the Commonwealth or industry, it will not remove the current costs being felt by some consumers. In this regard, some consumers may continue to be unable to access the key information regarding their HBHC insurance policies, which may result in these consumers having to face adverse outcomes if/when an adverse event, such as a flood occurs.

Option B: Introduce a KFS

1.90 The introduction of a KFS will enable Government to meet its objective by providing consumers with easy access to the basic terms of the insurance policy, including the nature of cover and any key exclusions.

1.91 This Option provides consumers with the key information on HBHC insurance policies. The KFS can be used as a guide to help consumers understand the different aspects of their HBHC insurance policies both before and after purchase.

1.92 This may enable easier comparison between different insurance policies and should also result in the chosen insurance policy better reflecting the consumer's preferences/requirements.

1.93 When considering the introduction of a KFS a number of Sub options can be considered. These include:

- *Option B1 — A fully prescribed one page KFS:* to provide consumers with a quick reference guide to enable a basic understanding of the policy type and what the policy **does** and **does not** cover.
- *Option B2 — A fully prescribed one page KFS that refers to the PDS:* to provide consumers with a quick reference guide that can also be used as a mechanism for consumers to become fully informed in relation to the policy type and what the policy **does** and **does not** cover.
- *Option B3 — A partially prescribed KFS:* to provide consumers with a quick reference guide similar to those in options B1 and B2. In addition, insurers will also be able to include or exclude certain information they deem to be or not be required by the consumer.
- *Option B4 — A non-prescribed document containing key information in relation to HBHC insurance policies:* to provide customers with a document to be used as a guide regarding the key information of the HBHC insurance policy. The document will be based on a general framework specified in the legislation but it will **not** be prescribed.

Other options

1.94 There are many possible options for providing consumer access to key information and addressing confusion surrounding and regarding HBHC insurance policies. However, no option will ever completely solve this problem as there will always be some consumers that fail to fully consider the impact of not taking the steps required to make effective decisions regarding their insurance needs.

Consumer education program/campaign

1.95 Consideration was initially given to an education program/campaign to inform consumers of the benefits of reading and understanding the information contained in HBHC insurance policy PDSs.

1.96 There may be a number of benefits to consumers from an education program/campaign including encouraging consumers to:

- ask questions about their insurance policies;

- seek advice when they fail to understand particular jargon/terminology; and
- become more active in the decision making process.

1.97 Although, an educational program/campaign may have a number of benefits, it was considered that it would not meet the Commonwealth's objective to assist consumers with understanding the basic terms of the insurance policy, including the nature of cover and any key exclusions. For the reasons outlined below, this option was not considered further.

1.98 An educational program may not be able to provide all of the key information in relation to all HBHC insurance policies currently in the insurance market and may potentially be seen as a promotion campaign for the insurance industry.

1.99 An educational program/campaign would need to be broad in order to address issues such as financial literacy and consumer engagement. A program/campaign that merely encourages consumers to read their insurance policy may potentially be of little benefit. The program/campaign may need to identify ways that consumers can demonstrate that they have read and understood their policies and other relevant documentation, on an ongoing basis.

1.100 There are also concerns about the duration of a successful education program/campaign. As most insurance policies last for short periods (usually one year), it may be difficult to effectively engage consumers as to the benefits of familiarising themselves with the detail of their policy documents each time they are required to renew or update their policies.

1.101 While it is recognised that the recent adverse outcomes experienced by consumers may prompt consumer engagement in the short term, this momentum may not continue in the longer term.

1.102 The effectiveness of an educational campaign/program as a standalone option has also been questioned. In a recent ASIC report into financial literacy and behavioural change³⁰, ASIC stated that:

‘while raising people’s level of financial knowledge forms the basis of many financial literacy initiatives around the world, there is a

30 Report 230 ‘Financial literacy and behavioural change’ released March 2011, <http://www.financialliteracy.gov.au/media/218309/financial-literacy-and-behavioural-change.pdf>

growing body of research suggesting that knowledge is only one factor when considering how to help people make positive financial decisions’

1.103 Finally, the introduction of educational program/campaign may not improve the accessibility of the key information in PDSs or act as a mechanism for improving the wording and format of disclosure documents.

1.104 While an educational campaign/program may not meet the Commonwealth’s objectives on its own, it could be used together with other measures to meet the Commonwealth’s objectives.

A targeted educational note/warning

1.105 It may also be possible for a targeted education note to be provided with insurance contracts. The provision of advice to consumers that the HBHC insurance policy contain a number of exclusions and that the PDS pertaining to the HBHC insurance policy should be read as it may reduce consumer confusion.

1.106 Furthermore, a standard educational note provided with policies may be less costly for industry (it must be noted that industry has not confirmed this at this stage), and may remind consumers that terms differ between policies, while leaving it to individual consumers to check the terms that matter to them.

1.107 While a targeted approach may be a useful tool to encourage consumers to familiarise themselves with the detail of any insurance product, this option was considered to have limited benefit when used in isolation from other measures.

1.108 In addition, a targeted note or warning would not improve the accessibility of the key information in PDSs or improve the understanding of the content of the PDS for some consumers.

1.109 However, it was recognised that the provision of instructions to consumers directing them to read the product disclosure statement and any other relevant material and/or ask questions of the insurer to satisfy themselves that they have an appropriate policy for their needs may contribute to a reduction in consumer confusion.

Inclusion in the Shorter PDS regime

1.110 When initially looking at the problems regarding confusion and the ability for consumers to access key information, consideration was given to including insurance policies in the Shorter PDS (SPDS) regime.

1.111 The SPDS regime has been designed to provide consumers with a shorter document for simple financial products. The SPDS regime currently applies to First Home Saver Accounts, margin loans and from 1 July 2012 will apply to simple Managed Investment Schemes (MIS) and superannuation products.

1.112 When considering this option the objectives of the proposal were, once again, carefully considered. It was recognised that the SPDS regime would potentially be an option that may achieve the objectives.

1.113 A benefit from having HBHC insurance policies in the SPDS regime is that consumers would have easier access to key information. In this regard, consumers will be more likely to be able to access key information in relation to HBHC insurance policies when the information is contained in a 4-8 page document.

1.114 Another benefit of moving HBHC insurance policies into the SPDS regime is that it may be less costly for industry than other options as a SPDS would replace the existing PDS and not be required to be provided in addition to the PDS. However it must be noted that initial costs incurred in developing a new shorter 4-8 page full disclosure document would be greater than the initial costs incurred for producing a one page document that does not provide full disclosure.

1.115 However, although this option had a number of benefits, for the reasons outlined below it was not considered further.

1.116 The SPDS regime has only recently been introduced into legislation and while it is expected to result in increases in consumer awareness in relation to the products covered, the effectiveness of the SPDS regime has not been fully established at this time.

1.117 Moving insurance products into the SPDS regime requires changes to the Corporations Act; in order for this to occur, extensive consultation and consideration would be required to ensure the underlying principles of the Corporations Act are maintained. This may increase the lead in time for any changes in the disclosure requirements for HBHC insurance policies.

1.118 The ability to target particular products is not easily achieved under the SPDS regime; therefore consideration would be required to be

given to the inclusion of all general insurance policies (this goes beyond the intended scope of the current Commonwealth objectives). However, it is recognised that General Insurance products may be suitable for inclusion in the SPDS regime at a future time.

Assessment of options

Option A – Keep the current requirements under sections 35 and 37 of the IC Act and Chapter 7 of the Corporations Act (Status Quo)

Impacts

Consumers

1.119 By maintaining the status quo, consumers will continue to be presented with a PDS containing large amounts of information. Key information required for consumers to make decisions about their HBHC insurance policies will continue to be provided but difficult to access in the PDS and policy documentation.

1.120 In addition, a PDS will continue to contain an amount of additional information that the insurer deems to be required by the consumer. Inclusion of this additional information by insurers may be seen by some consumers to add increased complexity and ambiguity which may lead to increased confusion. The effect of this confusion may be that consumers will have a lower level of protection than was originally intended in the legislation. Costs in the terms of time and effort may persist as consumers who choose to be adequately informed may continue to be required to read long and complex PDS documents.

1.121 More importantly, the current regime might encourage misguided decisions about the insurance cover provided under particular policies especially for consumers with low levels of financial literacy.

Industry

1.122 There will be no transition costs for HBHC insurance policy providers if the status quo maintained. Insurance policy providers are already developing insurance policy documents and PDSs in accordance with the sections 35 and 37 of the IC Act and Chapter 7 of the Corporations Act, so they are familiar with the current disclosure requirements.

1.123 The confusion surrounding insurance policies as a result of the current disclosure requirements may be seen in some circumstances to be

potentially leading to poor decision making by some consumers and as such may be resulting in underinsurance in some instances.

Commonwealth

1.124 Under Option A, there will be no change in benefits or costs regarding HBHC insurance policies.

Table 1.4 Impact assessment of Option A (status quo)

	<i>Benefits</i>	<i>Costs</i>
<i>Consumers</i>	No change	Some consumers will continue to be unable to access the key information regarding their HBHC insurance policies. This may in turn lead to adverse outcomes.
<i>Industry</i>	No change	No change
<i>Commonwealth</i>	No change	No change

Option B — Introduce a KFS

General Impact

1.125 The KFS is intended to provide information that is concise and easier to understand to assist consumers with their decision making. This may enable them to take out an insurance policy that best reflects their preferences.

1.126 The KFS will be required to be issued by insurers as soon as practicable after a consumer has requested information on a particular HBHC insurance policy, or in conjunction with the PDS (if the consumer has not previously obtained the KFS); and to have a copy of the KFS on their website for consumers to access.

1.127 The introduction of a KFS is expected to improve accessibility of the key information regarding HBHC which is expected to in turn reduce the current confusion surrounding these policies. Improvements in financial decision making have been recognised when financial disclosure documentation has been shortened.

1.128 In this regard, Chapter 6 of the Explanatory Memorandum to the National Consumer Credit Protection Amendment (Home Loans and Credit Cards) Bill 2011 stated that:

‘Empirical studies show that simplified and timely disclosure can improve consumer comprehension of credit contracts as well as improve decision making processes, such as encouraging them to consider a wider range of options and choosing the right option for them.’

1.129 Further, in mid May 2010 a final report was released, *Simplification of Disclosure Regulation for the Consumer Credit Code: Empirical Research and Redesign*. The report covered a number of elements of disclosure documentation on home loan products, the report indicated that:

- simplified precontractual disclosure greatly assisted consumers with improving their understanding of the cost of the credit contract;
- comprehension tests based on simplified disclosure was improved by factors of between 400 per cent and 1,800 per cent; and
- when exposed earlier to simple disclosure of key facts, consumers find comparison of products easier and make more informed choices.

1.130 A reduction in the number of disputes regarding the key facts of particular HBHC insurance policies is also expected to occur. As indicated in table 4.2 and table 4.3 the issues surrounding dispute claims are most likely to be related to consumers understanding of what exclusions/coverage they have under their HBHC insurance policies. It is expected that if consumers increase their knowledge and awareness of the key facts contained in their policies PDS they may make more effective decisions and as a result may secure adequate insurance cover for their needs.

1.131 The idea that effective disclosure is more likely to be achieved through shorter and sharper documents such as a shorter PDS document or KFS has been widely supported. This can be seen in the Supporting Material to the *Corporations Amendment Regulations 2010 (No. 5)* where it states:

‘The Government considers effective financial disclosure important so that consumers receive adequate information to make more informed and efficient choices, and have a higher level of accountability for their investment decisions. Effective disclosure then, means that the information is provided in such a way that consumers can easily locate and understand all the key information they require to make an informed decision’

1.132 The precise content and format of the KFS will be contained in Regulation and will be established through extensive consultation with key stakeholders to ensure effective policy outcomes are achieved. Therefore, it must be noted that the effectiveness and any potential benefits of this option cannot be fully measured at this time.

1.133 It is important to note, that even in cases where the presentation of financial information is succinct and assessable, consumers approach financial decisions with different levels of financial literacy.³¹ This can affect the effectiveness of a KFS and means that, even if a KFS is introduced, the desired benefits may not apply to consumers uniformly. That is, there may still be a number of consumers that may not even read a one page document prior to making their insurance decisions.

1.134 In this regard, it must be made clear that the introduction of a KFS in the following options will not be a substitute for the requirement for insurers to issue a PDS under the Corporations Act. Rather, insurers will be required to provide a KFS as well as a PDS.

Costs

1.135 The introduction of a KFS has received broad support from industry. However requiring industry to provide consumers with a document stating the key facts/information relating to their policy would impose additional compliance costs; primarily in the form of transitional costs.

1.136 The specific amount of compliance costs would be difficult to calculate as the complex nature of HBHC insurance policies would require different amounts to be calculated for each particular insurance policy and would depend on each insurance provider's current disclosure procedures.

1.137 The compliance costs for producing a KFS for home and content insurance policies has been estimated by the ICA, after consulting with a number of its members³², to be approximately \$1.2 million in the initial year and \$1.2 million every year thereafter. The compliance costs will be incurred in the establishment (statement development and legal costs), implementation (systems changes, website updates and front line staff

31 ANZ Survey of Adult Financial Literacy in Australia, http://www.anz.com/Documents/AU/Aboutanz/AN_5654_Adult_Fin_Lit_Report_08_Web_Report_full.pdf

32 Which, as asserted by the ICA, represent a significant proportion of the home and contents insurance policy market.

training costs) and ongoing annual costs (printing and distribution costs) of the KFS.

1.138 It is important to note that the initial and ongoing costs associated with the KFS are the estimated total combined cost for the insurers consulted and not for each individual insurer consulted. These costs are not to be taken to be the estimated costs for the entire insurance industry.

1.139 When looking at these estimates it is important to note that they are based on the assumption that the KFS is likely to be a highly prescribed document, provided together with the PDS and able to be provided electronically (and otherwise on request/on insurer's web page).

1.140 It is important to note that the cost of the introduction of the KFS would be likely to spread across insurance policies as insurers are unlikely to only allocate costs particular groups of consumers.

1.141 It must be made clear that under this option the total cost identified is likely to result in cost increases across all policies to address confusion concerns in relation to only a percentage of policy holders.

1.142 It is once again important to note that the nature of insurance is to protect consumers from incurring a loss when an unforeseen event occurs. An insurers' business is to provide consumers with this protection for unforeseen events for periods for which policies apply not to periods prior to that time.

1.143 The costs associated with the introduction of the KFS as outlined in the preceding paragraphs are expected to be minimal for most insurance providers. However, one HBHC insurance provider stated in their submission³³ to the '*Reforming flood insurance: Clearing the waters*' consultation paper that the introduction of a KFS

'might be advantageous in terms of simplicity, it would of course come at a significant cost for the industry and have prudential implications'

1.144 This statement however was not supported in any other submission to the '*Reforming flood insurance: Clearing the waters*'

33 The RACQ submission and other industry submissions can be found at:
<http://www.treasury.gov.au/contentitem.asp?ContentID=2039&NavID=037>

consultation paper. The expected costs are considered to be on a proportional basis the same for both small and large insurers.³⁴

1.145 While the actual costs incurred by industry are expected to be passed onto consumers, they are not expected to be a material consideration in the determination of HBHC insurance policy premiums. The introduction of a KFS is not expected to have a material impact on cost of HBHC insurance for consumers.

Expected content of the KFS

1.146 Submissions received on the proposal³⁵ have highlighted some of the key information that should be included in the KFS.

Type of policy

1.147 Outlining the type of policy (policy cover) provided by the HBHC insurance policy is considered to be one of the most significant aspects of the KFS. The exact format of how the policy type (policy cover) will be outlined has not been fully determined at this time. The approach currently being considered (outlined in the '*Reforming flood insurance: Clearing the waters*') is that insurers will be required to outline which of three categories the policy falls under (sum insured, sum insured plus margin and total replacement).

1.148 While it has been indicated that this approach has merit, some industry representatives have raised the concern that it may not reflect the level of diversity offered in relation to HBHC insurance policies. Consultation will be undertaken in order to determine the exact format for outlining what type of cover policy information on the KFS.

What is covered?

1.149 Currently, the ICR contain prescribed events that are required to be covered (standard cover events), unless a derogation applies. These events include, amongst others, fire or explosion, lightning or thunderbolt, earthquake, impact by a falling tree or part of a falling tree and riot or civil commotion. Although ideally the 'what is covered' section of the KFS would outline all of the standard cover prescribed events, limiting the KFS to one page renders this impossible. Further, not all of the prescribed events listed in the standard cover will be of significant consumer interest.

34 Smaller insurers generally have a stronger website focus and as such will provide consumers with online access to their KFSs therefore potentially minimising printing and distribution costs.

35 As outlined in '*Reforming flood insurance : Clearing the waters*'

1.150 Consultation will be undertaken in order to determine which of the prescribed events should be outlined on the KFS. In this regard, current feedback indicates that the main prescribed events of standard cover such as fire or explosion, storm, flood, accidental damage (in accordance with standard cover) are expected to be outlined on the KFS.

What is not covered?

1.151 Currently, the ICR contain prescribed events that are considered to be exclusions. These events include, amongst others, depreciation, wear and tear, rust or corrosion and the actions of insects or vermin. However in order to establish what is included in the ‘what is not covered’ list is not as easy as outlining all of these exclusions. Consideration is also required to be given to the prescribed events of standard cover that are not to be included in the ‘what is covered’ list. Consultation will be undertaken in order to determine which of the prescribed events that are considered to be exclusions and those other events that are not included in the ‘what is covered’ section are to be outlined on the KFS.

Cooling off period

1.152 Currently, it is proposed to include a short statement simply stating that a cooling off period applies to HBHC insurance policy which enables consumers to cancel the policy within that period. This allows flexibility for insurance providers to enable them to provide cooling off periods in excess of the statutory period.

How to use a KFS

1.153 Currently, it is proposed to include a simple statement indicating how a KFS is to be used. The statement will emphasise that it is only a guide and should not be used as a substitute for a PDS as a basis for making a purchasing decision.

Supplementary consideration for extending the application of a KFS

1.154 Initial consideration was given to potentially extending the KFS application to small business and strata title insurance policies. However, due to a number of potential issues, raised in consultation (paragraphs 4.204 and 4.209), associated with extending the KFS to these policies, this option was not considered further.

1.155 In this regard, insurance policies covering small business and strata title are usually tailored and are not required to address the standard cover obligations set down in the IC Act. This is in contrast to HBHC insurance policies which are substantially standardised and are required to the standard cover obligations set down in the IC Act.

Option B1 — the introduction of a one page, fully prescribed, KFS

Impacts

Consumers

1.156 The introduction of a one page fully prescribed KFS may facilitate increased simplicity, consistency and comparability when consumers are making decisions regarding the purchase of HBHC insurance policies.

1.157 A one page fully prescribed KFS will outline the key information in relation to the insurance policy in an easy to read and consumer friendly layout (determined through consumer testing). This layout may enable consumers to access the key information in a simple and effective way.

1.158 Having the KFS fully prescribed also provides consistency in the formatting and content of the KFS. This consistency provides consumers with a further level of familiarity (knowing what to look for and the meaning of certain words and concepts) that results, in more effective decision making.

1.159 The consistency provided in KFSs may allow consumers to easily compare one policy with another through the identification of the key facts and other relevant information.

1.160 The ability for consumers to be able to compare one insurance policy with another may result in increased competition within the insurance industry (however in must be recognised that the contents of the KFS may not necessarily include all matters that are of relevance to individual consumers) and provide potential financial savings for consumers. However, these potential benefits must be balanced with the potential costs for a consumer associated with the process of shopping around for the best policy for the consumer's needs.

1.161 Although the introduction of a KFS facilitates increases in simplicity, consistency and comparability, there is no guarantee that consumers will take advantage of these improvements. In order for consumers to obtain the benefits from the introduction of a fully prescribed KFS, consumers must still consider all of the key information, including that which is contained in the PDS, prior to making any insurance policy decisions.

1.162 What is and what is not covered under an insurance policy sometimes involves complex considerations³⁶. A fully prescribed KFS may not be able to cover all information that may need to be considered by individual consumers. The potential for relevant information, to be omitted, may result in consumers in particular circumstances making decisions based on incomplete information leading to adverse outcomes.³⁷

Industry

1.163 A fully prescribed KFS provides industry with a straightforward legislative process to facilitate the disclosure of the key facts of their HBHC insurance policies to consumers.

1.164 The benefits of Option B1 that have been identified in relation to consumers, that is, simplicity, consistency and comparability, can also be identified for industry. In this regard, once KFSs for HBHC insurance policies become part of standard industry practice (as required under this Option) HBHC insurance policy providers may have a simple and consistent way of communicating key product information to consumers.

1.165 Under Option B1 the KFS will be fully prescribed. While this allows the insurance industry to formulate standard procedures and methods for informing consumers it does not provide the same flexibility that is offered in Option B3. The insurance industry will only be required to provide consumers with a document containing key policy information (in addition to their current requirements under the Corporations Act and IC Act), which may minimise the increased compliance costs.

1.166 The cost expected to be incurred in regard to this Option have been outlined in the costs section of the introduction of a KFS paragraphs 4.135 to 4.150 above. This option is considered to have no other material costs for industry.

Commonwealth

1.167 Under Option B1 the Commonwealth will incur consultation, testing and implementation costs:

- Consultation costs will be incurred during the process of forming and finalising the Regulations that will give effect to the KFS.

36 National Insurance Brokers Association of Australia - Insurance Contracts Act Issues Other Than Section 54 (submission) ,

http://icareview.treasury.gov.au/content/_download/submissions_post_issues/niba.pdf

37 Insurance providers will however continue to be required to provide a PDS.

- Consumer testing cost will be incurred during the development of the KFS.
- Implementation costs associated with both the introduction of the legislative framework and Regulations will also be incurred.

1.168 In addition to the initial costs associated with introduction of a KFS, ongoing costs will be incurred for monitoring of the KFS. In this regard ASIC will administer the standard definition in line with its current responsibilities under the IC Act.

Table 1.5 Impact assessment of Option B1 (One page, fully prescribed, KFS)

	<i>Benefits</i>	<i>Costs</i>
<i>Consumers</i>	<p>Easy to read and consumer friendly layout (determined through consumer testing).</p> <p>Increased consistency as a result of prescribed formatting and content of the KFS.</p> <p>Easy to compare one policy with another through the identification of the key facts and other relevant information.</p>	<p>A fully prescribed KFS will not be able to cover all information relevant for individual consumers or consumer groups. This may result in decisions being made on some, but not all, of the relevant information.</p> <p>There is a potential risk that the KFS to be seen as a substitute for PDS.</p> <p>Any costs incurred by industry for producing a KFS is likely to be passed onto consumers through increases in premiums.</p>
<i>Industry</i>	<p>A simple and consistent way of communicating key product information to consumers.</p> <p>A mechanism to reduce the number of inferior HBHC insurance policies.</p>	<p>Initial costs associated with the introduction of the KFS, including assessment of HBHC insurance policies.</p> <p>Increased ongoing cost, including printing, production and distribution costs.</p>
<i>Commonwealth</i>		<p>Consultation, consumer testing and implementation costs will be incurred.</p> <p>Monitoring costs will also be incurred as ASIC will administer the standard definition in line with its</p>

		current responsibilities under the Insurance Contracts Act.
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Option B2 — the introduction of a one page, fully prescribed, KFS that refers to the PDS

Impacts

Consumers

1.169 The introduction of a one page fully prescribed KFS that refers to the PDS may facilitate increased simplicity, consistency and comparability when consumers are making decisions regarding the purchase of HBHC insurance policies.

1.170 The referencing aspect of Option B2 essentially creates an intrinsic link between the key information in the KFS and the disclosure information in the PDS. In effect the KFS will have two purposes; the first to provide consumers with a summary of the key information on the particular insurance policy and the second, to act as a potential guide to more detailed information contained in the PDS.

1.171 The incorporation of referencing enables consumers to access additional information on areas in the KFS that they consider to be crucial when making decisions. Consumers are able to increase their knowledge and awareness of their policy in accordance with the level of complexity they wish to adopt.

1.172 Although the introduction of a fully prescribed KFS that refers to a PDS facilitates increases in simplicity, consistency and comparability there is no guarantee that consumers will take advantage of these improvements. Furthermore, some consumers may see the inclusion of PDS referencing as just additional information that can be disregarded and as such fail to recognise its additional benefits.

1.173 In order for consumers to obtain the benefits from the introduction, consumers must still consider all the key information on the KFS and where possible all the other relevant information in the PDS prior to making any insurance policy decisions.

Industry

1.174 A one page fully prescribed KFS that refers to the PDS may provide industry with a straightforward legislated process to facilitate the disclosure of the key facts of their HBHC insurance policies to consumers. In addition, it may provide insurers with the ability to increase customer knowledge and awareness.

1.175 The benefits of Option B2 that have been identified in relation to consumers, that is, simplicity, consistency and comparability, can also be identified for industry. In this regard, once KFSs for HBHC insurance policies become standard industry practice (as required under Option B2) HBHC insurance policy providers may have a way of communicating key product information that is seen by consumers to be simple and easy to understand.

1.176 While this allows the insurance industry to formulate standard procedures and methods for informing consumers it does not provide the same flexibility that is offered in Option B3.

1.177 Under Option B2, HBHC insurance providers will be required to have references to the full PDS. This requirement may result in a reduction in the number of disputes from consumers having policies that fail to provide them with the appropriate cover. The reduction in disputes can be seen to be achieved though the increased level of knowledge and awareness displayed by consumers as a result of the easy access to the key information in the PDS.

1.178 The costs expected to be incurred in regard to Option B2 have been outlined in the costs section of the introduction of a KFS paragraphs 4.135 to 4.150 above. However, under Option B2 there is a potential for the costs to increase as a result of the inclusion of PDS referencing. In this regard, if the two documents (the PDS and KFS) are intrinsically connected any change in one document would require a change in the other. In order to address this issue insurers would be required to:

- implement new IT procedures and or practices to integrate the two documents, potentially creating a one-off compliance cost; or
- make individual changes to the documents as they occur, creating ongoing compliance costs.

Commonwealth

1.179 Under Option B2 the Commonwealth will incur consultation, testing and implementation costs:

- Consultation costs will be incurred during the process of forming and finalising the Regulations that will give effect to the KFS.
- Consumer testing cost will be incurred during the development of the KFS.
- Implementation costs associated with both the introduction of the legislative framework and Regulations will also be incurred.

1.180 In addition to the initial costs associated with introduction of a KFS, ongoing costs will be incurred for monitoring of the KFS. In this regard ASIC will administer the standard definition in line with its current responsibilities under the IC Act.

Table 1.6 Impact assessment of Option B2 (One page, fully prescribed, KFS, that refers to PDS)

	<i>Benefits</i>	<i>Costs</i>
<i>Consumers</i>	<p>Easy to read and consumer friendly layout (determined through consumer testing).</p> <p>Increased consistency as a result of prescribed formatting and content of the KFS.</p> <p>Ease of comparing one policy with another through the identification of the key facts and other relevant information.</p> <p>Ability for consumers to gain an increased knowledge and awareness of all aspects of their HBHC insurance policies.</p>	<p>That while a fully prescribed KFS that refers to the PDS will be able to cover all information relevant for individual consumers or consumer groups, there is a potential that consumers may not see its benefits and fail to look beyond its general content. This may result in decisions being made on some, but not all, of the relevant information.</p> <p>There is a potential risk that the KFS to be seen as a substitute for PDS.</p> <p>Any costs incurred by industry for producing a KFS are likely to be passed onto consumers through increases in premiums.</p>

	<i>Benefits</i>	<i>Costs</i>
<i>Industry</i>	<p>A simple and consistent way of communicating key product information to consumers.</p> <p>A mechanism to reduce the number of inferior HBHC insurance policies.</p> <p>Insurance providers should be able to reduce the number of disputes over the level of cover of its policies.</p>	<p>Initial costs associated with the introduction of the KFS, including assessment of HBHC insurance policies.</p> <p>Increased ongoing cost, including printing, production and distribution costs.</p> <p>Additional costs will be incurred as new IT procedures and or practices to integrate the two documents (KFS and PDS) will have to be established.</p>
<i>Commonwealth</i>		<p>Consultation, consumer testing and implementation costs will be incurred.</p> <p>Monitoring costs will also be incurred as ASIC will administer the KFS in line with its current responsibilities under the IC Act.</p>

Option B3 — the introduction of a partially prescribed KFS

Impacts

Consumers

1.181 The introduction of a partially prescribed KFS may facilitate an increased level of simplicity when consumers are making decisions regarding the purchase of HBHC insurance policies. Consistency and comparability may also be increased in the areas of the KFS that are prescribed.

1.182 If the KFS is partially prescribed consumers will have access to more tailored information for the insurance policy that they are considering/assessing. Under Option B3 a number of key aspects of the particular HBHC insurance policies will be prescribed³⁸; however the KFS may be tailored to include information (specific to the particular insurance

38 The prescribed section will be established through consultation with industry and consumer groups. It is envisioned that both the type of cover and the basic information regarding what is covered and what is not covered under the policy will be prescribed.

policy) to be disclosed in order to provide consumers with more relevant information.

1.183 The tailoring of particular insurance policy information allows consumers to make more simple and effective decisions as only the relevant information is required to be considered. However, the benefit of this tailoring is dependent on the consumer's use of the information.

1.184 The introduction of a partially prescribed KFS may provide increases in comparability for consumers but not to the same extent as Options B1 or B2. This is due to the fact that the non-prescribed sections of the KFS may potentially contain a diverse range of additional information. The loss of comparability under Option B3 may be contained as a result of the one page format.

Industry

1.185 The benefits of Option B3 that have been identified in relation to consumers, that is, simplicity, consistency and comparability can also be identified for industry. In this regard, once KFSs for HBHC insurance policies become standard industry practice (as required under Option B3) HBHC insurance policy providers may have a simple and consistent way of communicating key product information to consumers.

1.186 Option B3 also provides industry with a level of flexibility while still maintaining a level of comparability. This is achieved through the incorporation of both prescribed sections and non-prescribed sections. The prescribed sections of the KFS allow consumers and industry to compare products while the non-prescribed sections allow increased flexibility to include product specific information when required.

1.187 The costs expected to be incurred in regard to Option B3 have been outlined in the costs section of the introduction of a KFS paragraphs 4.135 to 4.150 above. However, under Option B3 there is a potential for compliance costs to increase as a result of the inclusion of the non-prescribed sections of the KFS. In this regard, insurers may be required to undertake further individual analysis of each of their HBHC insurance policies to determine the required content of the non-prescribed sections.

Commonwealth

1.188 Under Option B3, the Commonwealth will incur consultation, testing and implementation costs:

- Consultation costs will be incurred during the process of forming and finalising the Regulations that will give effect to the KFS.
- Consumer testing cost will be incurred during the development of the KFS.
- Implementation costs associated with both the introduction of the legislative framework and Regulations will also be incurred.

1.189 In addition to the initial costs associated with introduction of a KFS, ongoing costs will be incurred for monitoring of the KFS. In this regard ASIC will administer the standard definition in line with its current responsibilities under the IC Act.

Table 4.7 Impact assessment of Option B3 (One page, partially prescribed, KFS)

	<i>Benefits</i>	<i>Costs</i>
<i>Consumers</i>	<p>Easy to read and consumer friendly layout (determined through consumer testing).</p> <p>Consumers will have access to more tailored information for the insurance policy that they consider/assess.</p> <p>Consumers may be able to make more simple and effective decisions as all relevant information is included.</p> <p>Provides some increases in comparability for consumers.</p>	<p>There is a potential risk that the KFS to be seen as a substitute for PDS.</p> <p>Increases complexity as more information may be contained in some insurance policies.</p> <p>Not all the additional information included may be relevant to some consumers (the additional information will only be relevant if the consumer values it).</p> <p>Any costs incurred by industry for producing a KFS are likely to be passed onto consumers through increases in premiums.</p>
<i>Industry</i>	<p>A simple way of communicating key product information to consumers.</p> <p>A mechanism to reduce the number of inferior HBHC insurance policies.</p> <p>The ability to provide consumers with all relevant information thus reducing</p>	<p>Initial costs associated with the introduction of the KFS, including assessment of HBHC insurance policies.</p> <p>Increased ongoing cost, including printing, production and distribution costs.</p> <p>Insurers will be required to assess what additional facts</p>

	disputes over cover provided under the insurance policy.	(outside the facts already prescribed) should be.
	<i>Benefits</i>	<i>Costs</i>
<i>Industry (continued)</i>		provided to consumers. This will increase compliance costs and reduce certainty.
<i>Commonwealth</i>		Consultation, consumer testing and implementation costs will be incurred. Monitoring costs will also be incurred as ASIC will administer the KFS in line with its current responsibilities under the IC Act.

Option B4 — the introduction of a framework for the provision of a document that contains key information regarding a HBHC insurance policies (a non-prescribed KFS)

Impacts

Consumers

1.190 The introduction of a framework for the provision of a document that contains key information regarding HBHC insurance policies may improve consumer knowledge and awareness when making decisions regarding HBHC insurance policies.

1.191 Currently, disclosure for HBHC insurance policies is provided through the provision of the insurance policy and an accompanying PDS. The PDS regime is essentially a framework for disclosure of financial products. As discussed previously under the PDS regime a consumer may receive a 30 page, or longer PDS document.

1.192 The introduction of a framework to be used to produce a document that outlines the key facts may effectively ensure that the key information is contained in a manageable document, thus increasing simplicity and improving consumer knowledge and awareness. The framework will set out what type of information should be included in the KFS in a similar way to that of other disclosure documents such as PDSs and Shorter PDSs.

1.193 This may result in consumers being in a better position to make informed decisions regarding their insurance options and cover than is

currently the case. This is because consumers may receive simpler, more readable and standardised guidance on key facts regarding HBHC insurance policies.

1.194 While providing similar benefits to the first three options, Option B4 fails to adequately address the issue of confusion. The introduction of a framework will not require insurers to adopt a particular format or level of content that may result in the same increases in simplicity, consistency and comparability as the other options. It allows insurers to make judgements about what information they think consumers require in order to make effective decisions.

1.195 Furthermore, insurers may, in endeavouring to ensure that they meet the requirements under the framework, include more information than is required. The inclusion of this additional content may create further complexities that increase the current level of confusion surrounding HBHC insurance policies.

Industry

1.196 The benefits of Option B4 revolve mainly around the ability for insurers to customise the content and format of their KFS. Increased customisation allows insurers to increase the level of knowledge and awareness through the provision of specific policy information.

1.197 The ability to effectively determine the compliance cost under Option B4 is more complex than with the other potential options. This is due to the fact that under Option B4 the actual compliance costs are dependent on:

- the current practices of each individual insurance provider; and
- the changes insurance providers decide to make to their practices (this will depend on the amount of key information the insurance provider decides to include/not include).

1.198 In order to provide consumers with some level of increased simplicity, consistency and comparability the insurance industry may be required to introduce guidance regarding the format and content of the KFS (this may be accomplished through changes to the insurance industry's code of practice).

1.199 Although Option B4 is not strictly a KFS document the costs expected to be incurred are similar to those outlined in the costs section of the introduction of a KFS paragraphs 4.135 to 4.150 above. In this regard the cost saving that may be achieved through the increased amount of

flexibility Option B4 provides to insurers. The costs associated with establishing what level and type of information required to be included is considered to substantially offset these savings.

Commonwealth

1.200 Under Option B4 the Commonwealth will incur only minor consultation, implementation and ongoing monitoring costs.

Table 4.8 Impact assessment of Option B4 (framework for the provision of a document that contains key information regarding a HBHC insurance policies)

	<i>Benefits</i>	<i>Costs</i>
<i>Consumers</i>	<p>Key information regarding HBHC insurance policies will be contained in a manageable document, increasing simplicity and readability.</p> <p>Consumers will be able to make informed decisions regarding their insurance options and cover.</p>	<p>While providing greater simplicity than the <i>status quo</i> option (Option A), Option B4 fails to adequately address the issue of consumer confusion.</p> <p>Simplicity may increase as a result of the introduction of a framework, however, this is not guaranteed as insurers may include more information than is required thus actually increasing the complexity.</p> <p>Any costs incurred by industry for producing any additional disclosure documentation are likely to be passed onto consumers through increases in premiums.</p>
<i>Industry</i>	Minimal changes are required to meet the new requirements of the regulations.	Initial compliance costs associated with the introduction of the framework.
<i>Commonwealth</i>		Minor consultation, implementation and monitoring costs will also be incurred as ASIC will administer the KFS in line with its current responsibilities under the IC Act.

Consultation

Government consultation with insurance industry

1.201 The Government met with the insurance industry on numerous occasions. Many of these meetings have involved the Assistant Treasurer and Minister of Superannuation and Financial Services.

- 14 January 2011 — 1st meeting with insurance industry heads, and Qld government in Brisbane. This meeting focused on immediate response issues.
- 27 January 2011 — ICA issues 10 point plan in response to natural disasters. Calls for standard definition and improved disclosure.
- 3 February — 2nd meeting with the full ICA Board.
 - The Government and the ICA discussed the 10 point plan issued by the ICA.
 - The discussion included consideration of standard definition and one page key facts statement.
- 18 February 2011 — 3rd meeting with the full ICA Board.
 - The Govt and ICA reached in-principle agreement at this meeting to work towards a standard definition and one page key facts statement.
- 4 March 2011 — 4th meeting with the full ICA Board.
 - Further consideration of the details around a standard definition and one page key facts statement.
 - This conversation assisted the Government in developing '*Reforming flood insurance: Clearing the Waters*', the consultation paper containing a proposal in relation to a standard definition and one page key facts statement and seeking submissions.
- 5 April 2011 — Government released '*Reforming flood insurance: Clearing the Waters*' at a public forum in Ipswich.

- This forum was jointly attended by the Minister, the ICA and Qld Legal Aid.
- It was attended by hundreds of local people affected by the floods and included many representations in relation to consumer confusion in relation to flood coverage. Many people thought that they were covered for flood and weren't.
- 5 April 2011 — ICA publicly supports a standard definition and one page key fact statement.
- 16 May 2011 — ICA lodged submission to Clearing the Waters. Supportive of both standard definition and one page key facts statement.
- 14 July 2011 — ICA makes submission to the NDIR. .

Government consultation with consumer groups

- January 2011 — jointly, consumer groups issue a 12 point plan which includes recommendation to implement a standard definition of flood and a one page key facts statement.
- 31 March 2011 — Meeting with consumer group representatives re standard definition and one page key facts statement.
- May 2011 — consumer groups make joint submission to Clearing the Waters. Strongly argue for standard definition and key facts statement.

Reforming flood insurance — Clearing the waters

1.202 On 5 April 2011, the Commonwealth released a consultation paper '*Reforming flood insurance — Clearing the waters*' that identified issues and a number of options for improving the regulatory framework and other aspects of Australia's insurance market.

- The consultation paper contained two key proposals for consideration:
 - To introduce a standard definition (in plain English) for flood across HBHC insurance policies in order to ensure HBHC insurance policies are more easily understood, so

consumers are not surprised when they try to make a claim. Under the proposal, the term flood would only appear in an insurance policy if it is defined as the standard meaning of the term.

- The introduction of a single page KFS for HBHC insurance policies, to allow consumers to see at a glance, the key elements of the policy — what is covered and what is not.

1.203 Several submissions were received from interested stakeholders and of these 13 submissions were able to be made public and can be found on the Australian Treasury website: www.treasury.gov.au. Submissions indicated a broad level of support for an adoption of a standard definition of flood and a KFS. Submissions made a number of constructive observations and suggestions in response to the questions in the paper.

1.204 There were no substantial disagreements from either consumer groups or industry regarding the introductions of the KFS for HBHC insurance policies. There was however some disagreement regarding the exact content and format of the KFS with the main points of contention being that of providing references to the insurance policies PDS and the ability to have more flexibility regarding what is to be included in the ‘what is’ and ‘what is not’ covered sections of the KFS.

1.205 One area in which significant disagreement may have arisen was in relation to the potential for KFSs to be extended to Residential Strata Insurance Policies (RSIP).³⁹ There was a clear concern that as the fundamental nature of RSIP were different to that of HBHC the ability for RSIP providers would not be able to comply with the KFS requirements. The extension of the KFS to RSIP was not pursued due to their fundamentally different nature to HBHC insurance policies. That is, RSIP policies are usually tailored and are not required to address the standard cover obligations set down in the IC Act.

1.206 In addition, in relation to the costs associated with the introduction of a KFS, only one insurer, as discussed in paragraphs 4.143-4.144, stated that:

‘it would of course come at a significant cost for the industry and have prudential implications’

³⁹ The extension of the application of the KFS discussion regarding the consideration of this extension may be found in paragraphs 4.154 and 4.155.

1.207 However as stated in paragraph 4.144 this statement was not supported in any other submission to the 'Reforming flood insurance: Clearing the waters' consultation paper.

Consumer Comments

1.208 Consumer groups have indicated that they generally support the introduction of a KFS. Consumer groups consider that a KFS will:

- give consumers a better understanding of what their policy covers and what it does not, accepting the reality that very few people read and understand their PDS;
- help consumers shop around for insurance by allowing easy comparison between competing policies, thereby improving competition; and
- give consumers important information relating to their policies including information relating to under-insurance.

1.209 In relation to the type of KFS that should be introduced consumer groups have indicated that:

- a KFS must set out the most important points of the policy clearly and simply. By providing consumers with two documents, a KFS and a PDS detail will be retained but clarity and accessibility will be improved. This will lead to better decision making by consumers regarding insurance coverage, which is good for consumers, the industry and the community at large;
- they strongly support a fully prescribed KFS, as this will ensure clarity about what is and is not covered by the policy, and will allow easier comparison between products;
- by prescribing the events covered, exclusions for key events will be made clearer;
- if a KFS is not fully prescribed, insurers may simply avoid mentioning events that they do not cover, thus leading to unfavourable outcomes for consumers;
- if a partially prescribed KFS is adopted there must be a limit on the additional matters that insurers might otherwise choose to include in the 'what is covered' list but that are not essential to the consumer's understanding of the most important features of the product;

- if the KFS is not fully prescribed there is a potential for insurers to choose to list a number of matters on the KFS that are not essential to the policy that will make it harder for consumers to read and understand;
- although fully prescribing the list may not effectively capture all aspects of insurance cover under the policy, the greater risk is that insurers would provide too much information. Consumer groups have highlighted that it should be made clear that a KFS will not replace a PDS (as it cannot provide the same level of detail);
- if in the future the nature of insurance changes and different events emerge that are of more importance, the Regulations can be changed to allow other events to be included in the KFS; and
- cross referencing with the PDS should be included in the KFS to encourage consumers to read at least the sections of the PDS that are relevant to the insurance related decisions.

Industry Comments

1.210 The insurance industry has indicated its general support for the introduction of KFSs. The ICA released a media release⁴⁰ supporting the Commonwealth's release of the discussion paper *'Reforming Flood Insurance — Clearing the Waters'* stating that:

- they welcomed the release of the paper;
- they understand that the Australian community would like improved clarity on the availability of flood insurance and how it works;
- they have released a ten point plan⁴¹ to tackle disasters; and
- significant progress has been made on key issues outlined in the ten point plan. In particular, work is well progressed on:
 - a standard definition of flood;

40 Industry Continues Work on Flood Reforms, 5 April 2011, <http://www.insurancecouncil.com.au/Portals/24/Media%20Centre/2011%20Media%20Releases/ICA%20Media%20Release%20Flood%20Insurance%20050411.pdf>

41 Media release outlining the 10 Point Plan to Tackle Disasters, 27 January 2011, <http://www.insurancecouncil.com.au/Portals/24/Media%20Centre/2011%20Media%20Releases/ICA%20Release%20-%20Ten%20Point%20Plan%2027th.pdf>

- improved disclosure; and
- flood mapping.

1.211 In relation to the type of KFS that should be introduced the insurance industry has generally indicated that:

- the KFS should be prescribed and determined by Treasury in consultation with the Financial Services Disclosure Advisory Panel (with input from industry and consumer advocates);
- prescribing events has a number of advantages including:
 - certainty about the minimum amount of information required to be given;
 - reducing the possibility of disputes between consumers and insurers; and
 - protecting against allegations of misleading and deceptive conduct in relation to the content of the statement.
- the disadvantage of prescribing a KFS is that it will only ever facilitate comparability at the minimum coverage level and the content level of the KFS;
- not prescribing certain aspects of the KFS such as ‘what is covered’ means that insurers will be required to determine what goes into the document and this will result in insurers being exposed to the risk of unintentionally misleading consumers;
- one major difficulty with prescribing what is key information is that what is a key fact for one person is not for another. As such the Commonwealth should identify what it believes needs to be dealt with at a minimum;
- in situations where other exclusions/conditions in the policy are not included in the KFS where they would be required to be included for a particular consumer/consumers, it would be appropriate for the insurance industry and in particular insurance brokers to provide this additional information;
- the KFS should not refer to specific pages or paragraphs in the PDS. Apart from taking up additional space, specific references may change, making the statement inaccurate. Referring to specific pages/paragraphs could also cause consumers to read their contract in parts or in isolation; and

- referring to the PDS could create additional costs to the product if the insurer changes its policy wording and then has to also amend the KFS each time as well.

1.212 However a number of issues have been raised in the particular context of Residential Strata Insurance Policies (RSIP). In this regard, the following statements have been made:

- Whilst the proposed approach appears logical to allow comparison of HBHC insurance policies, doing so on a prescribed events-basis would be misleading in the case of Residential Strata.
- To satisfy all the various state based statutory requirements relating to Residential Strata insurance cover, insurers must provide cover via an ‘Accidental Damage Policy’.
- Accidental Damage policies provide broader cover and additional benefits to consumers not otherwise available via a prescribed/defined event loss cover.
- As RSIP are Accidental Damage Policies subject to exclusions, the differentiating factors from a Body Corporates perspective are the additional benefits provided by each insurer.
- Therefore in the case of RSIP it would be necessary to include ‘other’ covers to allow the Body Corporate to differentiate between products. Without an option to include ‘other’ covers the KFS would be misleading.

Conclusion and Recommended Option

1.213 Option B1 is the recommended Option. However, it is not possible at this time to conclude that Option B1 will address the problem and result in a net benefit as the size and the reasons for the problem are not shown through empirical evidence.

1.214 Further, it is important to note that the precise content and format of the KFS will be contained in Regulations and will be established through extensive consultation with key stakeholders. As such the effectiveness and benefits of this option cannot be fully measured at this time.

1.215 Option B1 is the most likely option to achieve the objective to assist consumers with understanding the basic terms of the insurance policy, including the nature of cover and any key exclusions.

1.216 Some potential benefits to consumers include:

- increased simplicity, consistency and comparability when consumers are making decisions regarding the purchase of HBHC insurance policies;
- an easy to read and consumer friendly document (determined through consumer testing);
- more effective decision making through an increased level of familiarity (knowing what to look for and the meaning of certain words and concepts) as a result of the introduction of the KFS; and
- increased financial and time savings from the increase in competition within the insurance industry.

1.217 Some potential benefits for industry include:

- a straightforward legislated process to facilitate the disclosure of the key facts pertaining to their HBHC insurance policies; and
- a simple and consistent way of communicating key product information to consumers.

1.218 In adopting Option B1 some costs will be incurred. The costs for consumers relate to the fact that the cost for insurers of providing a KFS is likely to be passed onto consumer through increased premiums :

1.219 The costs for industry for adopting Option B1 are primarily the costs associated with the:

- initial assessment of the policy required in order to establish the key information of the HBHC policy that is required to be included on the KFS; and
- printing, production and distribution of the one page fully prescribed KFS.

1.220 In conclusion, while there is no empirical evidence supporting the benefits of Option B1, qualitative and anecdotal evidence suggests that

there may be benefits for both consumers and industry. Therefore Option B1 is the recommended Option.

1.221 However, as stated in paragraph 4.213 above, due to the fact that the magnitude and the cause of the problem cannot be clearly established through empirical evidence, it is not possible at this time to conclude that Option B1 will address the problem and result in a net benefit.

Implementation and review

Implementation

Changes to the Insurance Contracts Act 1984

1.222 The legislative framework for a one page fully prescribed KFS would be introduced by an amendment to IC Act. New regulations would be required to be made to the *Insurance Contracts Regulation 1985* (ICR) to establish the content and format once the framework was introduced.

1.223 The introduction of a framework for a one page, fully prescribed KFS would be expected to be introduced into Parliament in November 2011 as part of a package of amendments to the IC Act.

1.224 There will be a two year transition period which will commence from the date the regulations are made. It is envisaged that a two year period will provide sufficient time for individual insurers to calculate the impact the proposed changes will have on their businesses; make the necessary amendments; and notify policy holders.

Consultation on the regulations covering the content and format of the KFS

1.225 Extensive consultation will take place on the content and format of the KFS. Consistent with comments received in submissions to the '*Reforming flood insurance: Clearing the waters*' consultation paper, the main consultation process would be expected to take place through the Financial Services Advisory Panel (FSAP).

1.226 In addition to consultation on the content and format of the KFS, consumer testing would be undertaken in order to ensure the Commonwealths objectives are met. The precise format of the consumer testing would be determined once the legislative framework for the KFS had been introduced.

1.227 There will be public consultation on the draft regulations so that consumer groups and industry representatives would be able to provide comment on the proposed content and format for the KFS.

1.228 Issues that will be consulted on include the use of certain sized text, prescribed wording, sections and terminology. Using the main industry consultation group would ensure that all key stakeholders dealing with HBHC insurance policies are properly consulted and will produce a more robust product.

1.229 It is expected that once the content and format of the KFS has been finalised, an implementation RIS will be prepared prior to the new regulations being made.

Review

1.230 The effectiveness of the proposed measure and legislative amendments would be monitored by ASIC. It is expected that the effectiveness and impact of the introduction of a one page fully prescribed KFS would be reviewed after a sufficient period of time had elapsed.

1.231 In this regard the time between the commencement of relevant regulations and any review of the operation of the regulations must allow for industry and consumer groups, as well as the Commonwealth, to have gathered sufficient data so as to contribute to a meaningful assessment of the success of the measure.