



28 February 2018

Manager

Insurance and Financial Services Unit
The Treasury
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To the Manager

RE: Disclosure in general insurance: improving consumer understanding

I write regarding the Treasury's discussion paper on disclosure in general insurance: improving consumer understanding.

To date, consumer protections in the general insurance industry have been too focused on disclosure as the solution to overly complicated, lengthy contracts. People buying general insurance are regularly presented with long and complex terms and conditions and expected to understand them. As a consumer protection measure, disclosure is limited and ineffective. Frequently insurers fail to live up to community standards and expectations. When people go to claim on their policy, they are often faced with loopholes or exceptions that mean they don't receive the benefit they expected from their insurance policy.

Better disclosure does have a role to play in improving the consumer experience in general insurance. However, this shouldn't be the first and main line of defence. Disclosure improvements need to be coupled with improved product design, including the standardisation of key terms. This short submission focuses on four key areas for improvements:

- renewal notices;
- standardised definition of key terms;
- Key Fact Sheets; and
- a modern approach to enhanced disclosure.

Improving renewal notices

Renewal notices should be more transparent and easy to understand. For purchasers of insurance, the renewal period is the key time to assess the value and suitability of their product. It can act as an important trigger to shop around, provided relevant information is clearly conveyed in the renewal notice.

At policy renewal time, a key piece of information is the comparison of the previous years' premium to the new rate. The UK Financial Conduct Authority tested this theory on 300,000 people and found that when the previous year premiums were included on renewal notices, 11-18% more people opted to switch

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providers or negotiate a better deal.¹ This is a simple, low-cost regulatory step that has a tangible impact in driving consumer behaviour and ultimately improving competitive tension in the market.

The following information should be required to be included in renewal notices:

- the price of the new policy if the consumer renews;
- any difference between the new price and the previous year's price;
- every annual price charged presented in ways similar found to that found on utility bills;
- the reasons for any change from the previous years;
- any substantial change of coverage;

This information should be provided in a clear, consumer-tested form.

CHOICE also recommends that insurance companies be required to provide the component pricing of their premiums to policyholders. This will increase transparency for consumers about their premium prices and will encourage both risk-mitigation strategies and switching. Currently insurers are not transparent about risk factors and their impact, or accepting of a person's individual circumstances that may mitigate this risk. Without this sort of transparency consumers find it more difficult to shop around and avoid insurers that are discriminating against them.

Component pricing will allow discerning consumers to have greater control and autonomy over their premium prices. For example, suppose a resident in North Queensland finds out that 30% of their home and contents insurance premium is due the risk of living in a cyclone-prone area. They could be empowered to make physical improvements to their property to mitigate the risk of cyclone damage, and use this risk-modifying behaviour as the basis for a reduction in premium prices.

Providing component pricing information will also let people better compare tailored quotes and adjust other factors that may contribute to insurance pricing. For example, quotes for car insurance are affected by a range of factors including whether a car is parked on-street or in a garage, the suburb it's kept in and even the colour of the car.² Policyholders should be able to easily see what data is being used to determine the prices they pay for insurance. Such an approach would align with the current Consumer Data Right reform process, centred around consumers' right to view and control information held about them.³

¹ FCA, 2015, 'FCA to require insurance firms to publish details of last year's premium', available at: <https://www.fca.org.uk/news/press-releases/fca-requireinsurance-firms-publish-details-last-year%E2%80%99s-premium>

² Car insurer Youi, for example, offers different prices based on the risk associated with different car colours <http://www.smh.com.au/business/banking-andfinance/does-youi-owe-you-insurer-accused-of-billing-without-consent-20160818-gqvrm.htm>

³ For details on the background to this reform, see Productivity Commission, 2017, Final Report - Data Availability and Use, <https://www.pc.gov.au/inquiries/completed/data-access/report>

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Standardised definition of key terms

CHOICE strongly recommends that key terms in the general insurance industry be standardised. A good disclosure process will not help people if key definitions are not standardised. This is particularly the case in general insurance where a definition hidden a hundred pages deep in a dense product disclosure statement can radically alter the value of a policy. As the Treasury has documented, the delay in defining flood in insurance contracts led to widespread consumer harm. A CHOICE supporter recently shared her personal challenges with this inaction:

"[During severe floods in Qld in 2011,] the downstairs of our home became unlivable as water rushed through downstairs. We woke to find our two children asleep and their beds surrounded by water.

Our insurer refused to cover us. We had flood cover, but apparently not stormwater cover. We lived halfway down a hill in Yarraman, Qld. A metre of water came through, the school below us was also affected, as well as surrounding houses, but we still weren't covered (others were).

The insurer said it was our poor drainage that made the water come through. Yet everyone else around us had similar damage and they were covered.

It took them eight months to decide that they wouldn't cover us! Eight months while I was pregnant and had two children without bedrooms!

It financially ruined us, and seven years later we are only just starting to get back on track."
Jasmin, QLD⁴

The Federal Government should lead the process to standardise key terms, with strong representation from consumer groups. Standardised definitions must meet community standards and expectations and must not seek to undermine coverage or consumer protections.

A review of Key Fact Sheets (KFS)

CHOICE welcomes a review of the role that KFS play as a means of enhancing people's understanding of the insurance policies they buy. This review should involve rigorous testing of how people engage with and understand the KFS and should result in proposed improvements

⁴ Name changed to protect privacy.



to the form and distribution of these documents. However, without standardising definitions of key terms in insurance contracts, the utility of KFS will continue to be called into question. Consumers are presented with a KFS that details exclusions and limits across a number of events. As has been well documented, these definitions as well as exclusions and limits vary widely across providers and make comparison incredibly difficult for consumers.

A modern approach to disclosure

CHOICE encourages the Treasury to consider introducing performance-based disclosure requirements alongside strengthened prescriptive disclosure requirements as a means to improve consumer understanding in insurance.

Prescriptive regulations - such as mandating that an insurance company provides a consumer with a Product Disclosure Statement - give specific instructions about what businesses must and must not do. Performance-based regulations provide goals towards which firms must work, but are less prescriptive in how those goals must be met.

While both tools are useful mechanisms for regulators to achieve their goals in an industry, prescriptive regulation requires only that certain actions be taken; performance-based regulation demands that outcomes be achieved. Businesses are regularly tested to ensure they are on track to meet goals but the model otherwise allows firms latitude in how they achieve set targets. Performance-based regulation allows for the flexibility and expert application of industry knowledge that is often touted as the benefit of self-regulation (but rarely if ever achieved in practice in the absence of mandated legislative requirements), coupled with the clear benefits of standard prescriptive regulation in that it is mandatory and compliance breaches can be punished.

Comprehension standards should be established alongside of prescriptive regulations to ensure that service providers' disclosures are effective - not disclosure for disclosures' sake, but disclosure aimed at conveying key information and ensuring a consumer understands it. Individual consumer understanding of product features, coverage, and costs would be measured at the time of purchase and at subsequent intervals.

Businesses would be required to ensure that a certain proportion of customers met a comprehension threshold. This could be done on the basis of a representative sample of an insurance company's customers. Existing disclosure requirements would continue and be strengthened to ensure comparability across products but beyond that businesses would have discretion on how to achieve comprehension targets. Businesses could be rewarded for surpassing targets and penalised when they are not met. This will also have the side effect of reducing over-complication in product design – any general insurance product that cannot be understood by enough customers would not be compliant.

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For further information please contact CHOICE on pveyret@choice.com.au

Yours sincerely,

A handwritten signature in black ink, appearing to be "Sarah Agar". The signature is fluid and cursive, with a prominent loop at the end.

Sarah Agar

Head of Campaigns and Policy

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