

Consumer Policy Inquiry
Productivity Commission
PO Box 80
BELCONNEN ACT 2616

Attention: Ms Jill Irvine

11 May 2007

Dear Ms Irvine

Consumer Policy Framework

The Insurance Council of Australia Limited (Insurance Council)¹ is pleased to provide input to the Productivity Commission's review of Australia's consumer policy framework.

The Insurance Council understands that the Productivity Commission (Commission) is not undertaking a review of consumer protection in specific sectors. However, in line with the invitation in the Issues Paper, the Insurance Council would like to put forward the general insurance industry as an example which illustrates a number of matters which we believe need to be addressed in consumer policy.

Effective Regulation

The Insurance Council has been active for a number of years in arguing for a more effective approach to regulation. The submissions which the Insurance Council made to the Banks Taskforce review of Business Regulation raised a range of important issues concerning regulation. (Copies of these submissions have been provided to the Commission.) Issues common and relevant to the current inquiry are:

- improving the regulatory process;
- removing and preventing unnecessary regulatory burden;
- resolving overlapping jurisdictional responsibilities; and
- the benefits of allowing industry to develop self regulation.

¹ The Insurance Council of Australia Limited is the representative body of the general insurance industry in Australia. Our members represent more than 90 percent of total premium income written by private sector general insurers.

Insurance Council members provide non life insurance products ranging from those usually purchased by individuals (such as home and contents insurance, travel insurance, motor vehicle insurance) to those purchased by small businesses and larger organisations (such as product and public liability insurance, workers compensation, commercial property, and directors and officers insurance).

Australian general insurers issue more than 42 million insurance policies annually and deal with 3.5 million claims each year. On average, about \$70 million in claims is paid each working day. Insurance Council members are therefore vitally concerned with issues of consumer protection. This is particularly the case with the very competitive general insurance market which applies in Australia.

The Insurance Council continues to press for more effective regulation. It is engaged with the other members of the Financial Industry Council of Australia (FICA) in its work with ASIC to develop an agreed cost/benefit template to enable industry to provide credible input to the evaluation of regulatory initiatives and existing regulation.²

Jurisdictional Overlap in Consumer Protection

Members have not raised with the Insurance Council major issues with the generic protections provided to consumers of financial services by the ASIC and Corporations Acts (which mirror provisions in the Trade Practices Act). There is potential for duplication and inconsistency with State fair trading provisions, but at least in the consumer protection area, jurisdictional overlap has not presented a major problem in practice.

Inappropriate Regulation of General Insurance

The problem for general insurers is the provisions of the Corporations Act which resulted from the Financial Services Reform Act (FSRA). While the licensing provisions can be seen as warranted in order to enable consumers to have confidence that those providing financial products and services meet minimum standards, the disclosure provisions intended to address information asymmetries between the product/service provider and the consumer were also applied generally across the financial services sector.

In theory, uniformity of regulation had its appeal, given the convergence which had been predicted for the financial services industry. However, it set a level of information disclosure above that needed for the purchase of general insurance by retail clients. The Insurance Council contends that a rigorous cost/benefit analysis of the impact of applying FSRA to general insurance would not have supported the case for this level of regulation.

The result has been considerable expense and effort by general insurers to comply with unnecessary disclosure provisions and the cost, inconvenience and potential confusion to consumers who receive documentation far beyond their requirements.

Industry and Government, Ministers, Treasury and ASIC, have worked to wind back the excesses of the regulatory regime. The first round of FSR refinements for example resulted in an exemption from having to provide Statements of Advice (SoAs) when selling a general insurance product, apart from sickness and accident cover. Discussions are taking place with Treasury at the moment on a number of proposals in the second FSR refinements package. This "finetuning" would not be necessary if value for consumers of detailed disclosure for general insurance had been more closely looked at when the legislation was being framed.

Need for Cost/Benefit Analysis

The Insurance Council is keen to see the application of cost/benefit analysis to deal effectively with the questions raised in the Issues Paper for example, Intermediaries; the impact of IT developments and whether specific unfair contracts legislation is needed. The

² FICA is also working with ASIC on a conference later in the year designed to look at important aspects of the regulation making process.

extent of a problem needs to be clearly identified before the need for a solution can be decided.³

With the need for cost/benefit analysis now being commonly raised to improve the evaluation of regulation, the Insurance Council advocates the development and use of consistent methodology, certainly at least across the one industry such as financial services. This is a major reason for the Insurance Council's work with FICA and ASIC on a cost/benefit template.

In determining the balance between cost and benefit, it is essential to ensure that the application of Australia's competition laws remain in step with the competitive pressures faced by the Australian economy and businesses. The Insurance Council opposes any legislative or regulatory change that results in legitimate conduct between insurance companies and preferred suppliers being prohibited or restricted in order to protect some businesses from competition. The interests of the consumer and the efficiency of the wider economy should always be considered.

As the ACCC Chairman has noted:

"One of the difficulties is that there is not a wide understanding of the difference between protecting competitors and promotion of competition. And while small business will seek for the focus of competition policy to tend more towards a philosophy of the protection of competitors, ostensibly in the interests of the promotion of competition, the voice of the consumer will be constantly heard urging that the focus remain on the promotion of competition with its attendant consumer benefits."⁴

Self Regulation

With a less prescriptive, more flexible approach to regulation by legislation, there would be greater scope for industry self regulation. Industry self regulation provides a benchmark standard. Once this standard is set, there is a strong incentive for individuals companies to exceed the benchmark in order to attract customers and expand market share.

The Insurance Council is already active in this area with its General Insurance Code of Practice (copy attached), the first version of which was developed by the Insurance Council and commenced operation in 1994.

The Code has been designed to raise the customer service standards in the Australian general insurance industry and protect the rights of policyholders. It is the general insurance industry's promise to be open fair and honest in the way it deals with all its customers. The Code has been written in plain language so that it is easy to read and understand. The current Code commenced on 18 July 2006 after a 12 month transition period.

³ While understanding that taxation is not a focus of the current inquiry, the Insurance Council would also like to see analysis done of the impact of taxation, particularly State duties and levies (for example the Fire Services Levy), on the take up of insurance. It makes little sense from a public policy viewpoint to impose taxes which discourage the use of risk management products which benefit both the individual and society as a whole. The New South Wales Fire Services Levy directly increases the cost of home insurance in that State by just on 20 per cent and when the compounding effect of GST and other State taxes such as stamp duty is considered, the increase in premium can be over 40%.

⁴ Graeme Samuel, "Big Business v Small Business – vigorous or vicious competition?" Australian Graduate School of Management Dinner, 4 November 2004, page 11.

The Code was developed in partnership with consumers, business, and the insurance industry. There was extensive consultation with the Consumers' Federation of Australia, Australian Chamber of Commerce and Industry, Office of Small Business, the Insurance Ombudsman Service (IOS) [for further detail on IOS, see 'Dispute Resolution' page 5] and other industry groups, whose significant contribution was vital in the development of the Code.

During 2004, there was a three month public consultation period on the draft Code of Practice to give consumers, business and government an opportunity to have their say on what they would like in a new Code. David Knott, former Australian Securities and Investments Commission Chairman reviewed all the submissions received and made 36 recommendations in his Independent Review. The Code incorporates all thirty six of Mr Knott's recommendations.

The Code of Practice specifically addresses the following areas:

- buying insurance
- making a claim
- financial hardship
- catastrophes and disasters
- consumer information and education
- complaints and disputes
- monitoring and enforcement of the Code.

General principles covered by the Code of Practice include:

- All customer services (including product information, sales procedures, claims handling and the management of complaints or disputes) will be conducted in a fair, transparent and timely manner.
- If an error is made in assessing applications, deciding on claims or investigating complaints, the insurer will take immediate action to correct it.
- Customers will have access to any information that has been used to assess applications, claims or complaints and will have the opportunity to correct any mistakes or inaccuracies within this information.
- Insurers will make sure that not only its employees, but also its Authorised Representatives and Service Providers meet the standards in the Code.

Each company that has signed up is monitored by the IOS to make sure they are meeting the standards in the Code. If a company falls short, it can be required to take action to fix the problem and sanctions may be imposed.

As the Commission has observed, the effectiveness of self regulation is limited by percentage of the industry which adheres to a particular code. However, with the General Insurance Code of Practice, the fact that Insurance Council membership represents ninety per cent of the general insurance industry ensures very wide compliance. Importantly, because of the Code's high profile, non Council members have also adopted its obligation.

In his foreword to the current Code of Practice in July 2006, the Parliamentary Secretary to the Treasurer, the Hon Chris Pearce MP said:

“The Australian Government fully supports the general insurance industry’s adoption of the Code of Practice and believes it is a practical demonstration of the industry’s commitment to going beyond legislation, to ensure a high level of service for its customers.”

Mr Pearce goes on to say:

“Through developing the Code, the industry has demonstrated a desire to ensure a transparent claims relationship between the insurer and its customers – evidence of which is well highlighted in a recent Insurance Ombudsman Service Report”.

Dispute Resolution

An important aspect of the dedication of Insurance Council members to good client relations is providing free access to dispute resolution mechanisms. The Code requires both an internal mechanism and membership of the IOS which is the principal complaints resolution scheme insurance industry for the general insurance industry. The IOS was originally established under the name of Insurance Enquiries and Complaints Ltd in 1991 by Insurance Council members as an independent external dispute resolution scheme. The IOS hears disputes about:

- decisions to refuse to pay a claim or
- the amount that should be paid under a claim, if the claim is for \$290,000 or less.

IOS cannot hear disputes about the price of a policy or loss of a no claim bonus.

The Insurance Brokers Dispute Facility is a special complaints resolution scheme that hears disputes between consumers and participating insurance brokers. Its jurisdiction relates to acts by the broker and not the general insurance itself. Also, if a claim was made under an insurance policy provided through a superannuation fund, a consumer can also take their case to the Superannuation Complaints Tribunal.

When the Insurance Council appeared before the Commission on 17 April 2007, it was asked a general question about possible consumer confusion concerning the availability of multiple avenues for external dispute resolution.⁵ It can be seen from the information above that this issue does not arise for general insurance.

Self Regulatory Initiatives

Self regulatory initiatives pursued by the Insurance Council and its members include extensive work on non and under insurance, as well as microinsurance.

The Insurance Council remains concerned about the extent of non insurance in the Australian community. According to the Australian Bureau of Statistics, some 1.8 million Australian households reported not having purchased any house and contents insurance. To better understand and profile non insurance in the Australian community, the Insurance Council commissioned the Centre for Law and Economics at the Australian National University (ANU) to examine the issue.

The ANU study “The Non Insured: Who, Why and Trends” (available at www.insurancecouncil.com.au) highlights the drivers of non insurance in the Australian

⁵ The Corporations Act requires Australian Financial Services Licence holders to be members of an ASIC approved external disputes resolution scheme.

community and the impact of government policies on non insurance. The study utilises both the ABS Household Expenditure Survey and the Roy Morgan Single Source Survey to identify and profile the non insured and the drivers of non insurance.

The study confirms that non insurance is a significant issue in the Australian community. According to the study, some 200,000 Australian households are without any form of building insurance at all – either directly or indirectly through a body corporate. The study finds that house type and tenure are significant drivers of non insurance and that affordability is a further constraint to the take up of insurance. The study also indicates that the lower level of household savings (and hence the greater the exposure to loss) the less likely you are to be insured.

The findings of the *Who, Why and Trends* report serves to challenge the suggestion in the Productivity Commission's Issues Paper that households may over insure compared to their risk situation. To the contrary, the ANU report concludes that non insurance is a significant problem in the Australian community and that government policies (such as insurance premium taxes) serve to distort consumer behaviour.

The serious commitment of Insurance Council members to addressing under insurance was demonstrated by ASIC's report "Making Home Insurance Better" (released on 25 January) which found that home building insurers across Australia have improved their policies and are providing consumers with better access to information about the costs of rebuilding. Initiatives have included:

- the introduction of 'total replacement' policies. These policies pay the rebuilding costs in full, rather than paying the 'sum insured';
- the introduction of 'extended replacement' policies, which pay 25 per cent or 30 per cent above the original 'sum insured';
- provision of access to more accurate calculators to estimate rebuilding costs; and
- providing consumers with educational messages about underinsurance, particularly on renewal.

Microinsurance is the protection of low-income households against specific perils in exchange for premium payments proportionate to the likelihood and cost of the risk involved. The main difference between this type of insurance and conventional forms is the way it is managed for the type of customers it is designed for. An example would be the collection of a premium in cash or somehow tied to fixed income streams.

The Insurance Council and its members are exploring with the Brotherhood of St Laurence, the Smith Family and other consumer representatives how microinsurance concepts can be used to widen access to affordable insurance, particularly to those in lower socio-economic groups.

Determining appropriate levels of Disclosure

When considering the point made by the Insurance Council at the Commission's hearing on 17 April that the FSR disclosure requirements for general insurance are excessive, the Commission asked how the appropriate level of disclosure could be ascertained. The suggestion was made Mr Potts of varying levels of information being available beyond an agreed minimum. These could be accessed according to the consumer's interest.

The Insurance Council believes that, apart from embedding in legislation the broad lines of the principle that consumers should be given all necessary information in order for them to make an informed decision, the detail of disclosure should be left to the Licensee to determine in light of their clients' requirements. General insurers have a vested commercial interest in clients buying appropriate policies after informed consideration.

Rather than creating information packages pitched at different levels of interest and consumer literacy, the Insurance Council believes it is far more efficient to facilitate the provision of cost effective means of giving individual consumers the information they require, through channels which the consumer finds convenient. This is the general insurance industry's motivation for seeking greater regulatory scope for general insurers to provide information, for example across the counter or through call centres, without triggering all the personal advice obligations within the Corporations Act.

The Commissioners also suggested that the consumer should be able to rely on an understanding that there was nothing unusual in the insurance contract which had not been drawn to their attention. This already applies to insurance contracts due to section 37 of the Insurance Contract Act concerning notification of unusual terms:

"An insurer may not rely on a provision included in a contract of insurance (not being a prescribed contract) of a kind that is not usually included in contracts of insurance that provide similar insurance cover unless, before the contract was entered into the insurer clearly informed the insured in writing of the effect of the provision (whether by providing the insured with a document containing the provisions, or the relevant provisions, of the proposed contract or otherwise)."

Experience and view of Victorian Unfair Contracts Act

The Insurance Council was asked when it appeared before the Commission to comment on the experience of its members with the unfair contract provisions of the Victorian Fair Trading Act. After putting the question to members, no instance of these provisions being applied against a general insurer was raised with the Insurance Council.

In considering the application of unfair contracts legislation to the general insurance industry, the Insurance Council notes that there are several relevant regulatory instruments which already exist. The principle of utmost good faith has long been recognised by the common law as applying to both parties to an insurance contract. Much of the operation of this principle was codified in the detailed provisions of the Insurance Contracts Act 1984. The Corporations Act also requires that an Australian Financial Services Licensee provide the financial services under its licence "efficiently, honestly and fairly".⁶

These statutory provisions have been supplemented by the Insurance Council's Code of Practice which sets out several obligations in regards to fairness. For example:

- 1.18(a) The provisions will be applied having regards ... to the duty of utmost good faith.
- 2.4 "Our sales process will be conducted in a fair, honest and transparent manner."
- 2.4.1 "Our employees will conduct their services in an honest, efficient, fair and transparent manner."
- 3.4.1 "We will conduct claims handling in a fair transparent and timely manner."

⁶ Corporations Act 2001, s912A(1)(a).

- 4.2 “We will respond to catastrophes in a fast, professional and practical way and in a compassionate manner.”
- 6.1.1 “We will conduct complaints handling in a fair transparent and timely manner.”

It is against this background of strong obligations on general insurers to act fairly that the Insurance Council argues that there is no need for additional legislation in this area.

Conclusion

The Insurance Council is pleased to have been able to provide input to the Commission’s inquiry into the consumer policy framework, through both its appearance before the Commission on 17 April and this submission. We believe that general insurance provides a clear example of where stronger application of cost/benefit analysis before its inclusion in the general financial services regulatory regime would have led to a better result for consumers and business. If such work had been undertaken, then the value of the generic consumer protection laws would have been recognised and greater scope allowed for industry to self regulatory initiatives more closely attuned to the needs of their customers.

Please do not hesitate to contact John Anning, General Manager Policy, Regulation Directorate, on (02) 9253 5121 or janning@insurancecouncil.com.au, if you have any questions or comments in regard to this submission.

Yours sincerely



Kerrie Kelly
Executive Director & CEO