Northern Australia Insurance Inquiry

Submission by the Australian Securities and Investments Commission

April 2019

Contents

Executive summary

1 The Australian Securities and Investments Commission (ASIC) welcomes the opportunity to provide feedback on draft recommendations in the first interim report of the Northern Australia Insurance Inquiry issued by the Australian Competition and Consumer Commission (ACCC) in November 2018.

2 We consider that a number of the draft recommendations have the potential for significant positive effects for consumers and we would welcome the ACCC formally recommending them to the Government.

3 In particular, we agree that minimum industry standards would help to ensure insurers act fairly and reasonably when proposing or agreeing to cash settlements. We are also of the view that, consistent with the Government's intent, claims handling (which would include cash settlement arrangements) should be included as a 'financial service' for the purpose of the *Corporations Act 2001* (Corporations Act).

Limitations of disclosure

4 Some of the draft recommendations rely on strengthening disclosures by insurers to consumers. In ASIC's view, future work of the Northern Australian Insurance Inquiry would benefit from considering a range of potential regulatory tools to address the issues of concern identified in the report, alongside the current focus on disclosure.

5 This broader focus would take into account the likely impact of:

(a) the reform agenda following on from the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Royal Commission), which, for example, picks up on the draft recommendations in the first interim report to apply the unfair contract term protections in the *Australian Securities and Investments Commission Act 2001* (ASIC Act) to insurance contracts; and

(b) the proposed design and distribution obligations, which will increase accountability for issuers and distributors across the product life cycle, rebalancing the responsibility for product suitability decisions between consumers and industry.

Note: See Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Bill 2019, which was passed by Parliament on 3 April 2019 and received royal assent on 5 April 2019.

6 Taken together with the proposed product intervention power for ASIC, these reforms will allow ASIC to take a broader regulatory approach beyond disclosure-based interventions to improve consumer outcomes for insurance.

Comments on specific draft recommendations

7 We support further work being undertaken on the following specific draft recommendations in the first interim report. We agree they may potentially facilitate improvements in consumer outcomes (although they are unlikely to be complete solutions in and of themselves):

(a) *Estimate of sum insured*—We support insurers being required to provide consumers with an estimate of the sum insured as doing so will provide several benefits, including potentially addressing the long-standing and concerning problem of underinsurance.

(b) *Home insurance comparison service*—We support exploring the utility of a national home insurance comparison service. We see value in undertaking consumer research to better understand the benefits to consumers. A comparison service may help consumers identify insurers that offer products in their geographic area and compare those products to identify ones that meet their needs. We consider that greater conformance by insurers with the standard cover regime and wider use of standardised definitions of key terms would enhance the comparability of products and make a comparison service more effective.

(c) *Renewal notices giving 28 days' notice*—We support a requirement that insurance renewal notices give 28 days' notice as this would support other efforts aimed at encouraging consumers to engage more closely with their insurance decisions at policy renewal, including by providing additional time to shop around.

(d) *Consumer choice in claims settlement*—We agree that consumers should have more control over how claims are settled, including the right to choose whether a claim is settled with a cash settlement or with a repair or rebuild by the insurer. We consider that these changes would address some of the issues associated with claims settlement that were highlighted in evidence during the Royal Commission.

(e) *Clearly stated mitigations discounts/risk mitigation to reduce premiums*—We would strongly support a requirement that insurers reward homeowners who undertake effective risk mitigation measures with a transparent pre-determined premium reduction. Such a proposal could help consumers to reduce their insurance cost.

8 If any of the draft recommendations are formally recommended to the Government for implementation, we suggest that the ACCC also recommend that any implemented measures be monitored and tested to assess their effectiveness in achieving their intended purpose and to identify any unintended consequences.

A Limitations of disclosure

Key points

Evidence shows that disclosure documents do not always enhance consumer decision-making, help with product comparisons or prevent consumers buying unsuitable products.

Insurers must therefore go beyond 'innovative disclosure' initiatives and integrate product design, sales and marketing processes to improve consumer understanding and outcomes.

Rationale for ASIC's approach to disclosure

9 Well-designed disclosure can:

(a) contribute to market transparency and efficiency;

(b) provide information that is valuable to the private sector and to regulators;

(c) facilitate innovative development of private sector applications or tools; and

(d) act as a post-purchase reference document for consumers in the event of a dispute.

10 However, in the insurance market, as in other financial services markets, there has been an assumption that disclosure will also, in effect, remedy competition failures, misaligned incentives, and poorly designed products.

11 In ASIC's view this puts too much weight on disclosure and other decision aids to fix problems that they cannot fix, to drive competition and/or to protect consumers. Disclosure should be complemented by the development and use of more effective regulatory tools.

Evidence of the limitations of disclosure

12 There is now a strong body of evidence concluding that mandatory disclosure documents (including even shorter, graphic or 'improved' disclosures) do not always enhance consumer decision-making, help consumers to make real-time comparison of products and services to their benefit, or prevent them from actively avoiding unsuitable products.

Note: See, for example, Omri Ben-Shahar and Carl E Schneider, *The failure of mandated disclosure*, 159 University of Pennsylvania Law Review 687, 2011; T Gillis, *Putting disclosure to the test: Towards better evidence-based policy*, 2015, p. 47.

13 Recent research by Monash University provides evidence of limitations on the effectiveness of Product Disclosure Statements (PDSs) and Key Fact Sheets in influencing consumer decisions.

14 The research examined the effectiveness of home contents PDSs and Key Facts Sheets in assisting consumers to select the policy that best suited their needs. It found that:

> despite ideal and simplified conditions, up to 42% of participants chose the worst offer, despite being given the time and opportunity to review the disclosure information. When able to choose from three policies, 35% chose the worse policy and only 46% found and selected the best policy.
>
> There was no simple and consistent effect of disclosure—while participants were more likely to forego purchasing an insurance policy when they had only access to the PDS the results did not find a clear pattern of understanding where people were provided more or less disclosure information.
>
> Purchasing decisions were not affected by the way in which the consumer viewed the disclosure (i.e. computer or smart phone).

Note: See J Malbon and H Oppewal, *(In)effective disclosure: An experimental study of consumers purchasing home contents insurance*, research report of a study commissioned by the Financial Rights Legal Centre, Monash University, Melbourne, 2018.

15 Consistent with these findings, ASIC research suggests that:

(a) most consumers do not read large amounts of disclosure documents properly or at all;

(b) consumers overestimate their level of understanding of information disclosed; and

(c) even simplified, tested, 'dashboards' can still be prone to misuse (by consumers) and manipulation (by insurers).

Note: See Susan Bell Research, *The provision of consumer research regarding financial product disclosure documents*, Financial Services Working Group; Hazel Bateman et al, *As easy as pie: How retirement savers use prescribed investment disclosures*, Research Paper 326, Quantitative Finance Research Centre, March 2013.

16 Some of the limitations of disclosure that ASIC has identified that help explain these failings include the following:

(a) *Disclosure is not always consistent*—Decisions about, and insurer adjustments to, every small design aspect of disclosure and other decision aids (e.g. size, order, consistency, placement, format) can significantly affect the extent to which and how different consumers access, assess and act on the information presented, including in negative ways that are not anticipated by policy makers.

(b) *Disclosure is generalised*—It is not designed to maximise a consumer's understanding of the product as it applies to them individually and fails to account for the fact that any one piece of information is used and understood differently from person to person and situation to situation.

(c) *Disclosure typically occurs at a time when it is unlikely to be relevant to consumer decision making*—For example, disclosure may be provided after the consumer has already made the decision to purchase the product. All forms of disclosure compete with more compelling and timely influences (such as sales staff, advertising and friends and family).

(d) *Financial products are inherently complex*—This is particularly the case where the consumer needs to assess risk, probability and the uncertain future performance of the product based on limited information and with innately constrained cognitive capacity. Product complexity and sales techniques can also defeat consumer attempts at understanding even simplified disclosures (e.g. confusing and opaque 'discounts', unclear fee descriptors).

17 Some disclosure and decision aids may be of some assistance to some consumers at some times, but it is important to monitor and assess the impact of these tools on consumer outcomes, including identifying unintended negative impacts.

Over-reliance on disclosure and the role of the insurance sector

18 A heavy reliance on disclosure places the onus on the consumer to protect themselves and drive a fair and well-functioning insurance sector. ASIC considers that this burden on consumers is inconsistent with recognised research and knowledge about consumer behaviour and permits market conduct that is inconsistent with community expectations.

19 In general, disclosure-based approaches rely on assumptions that disclosure will be effective in overcoming limitations in consumer understanding and behavioural biases, consumers will use information optimally in a narrow instrumental sense, that they are not prone to decision biases, and that they have the ability to undertake complex comparisons and calculations. These assumptions are at odds with how people actually do and can behave in many decision-making contexts in financial markets.

20 Disclosure-based approaches also fail to adequately take into account the extent to which insurers with misaligned incentives can put in place supply side barriers to a fair, well-functioning insurance sector—for example, by creating or taking advantage of consumer confusion, and subtly nudging consumers towards product purchases and uses that further commercial rather than consumer interests.

21 Communications by insurers and distributers are inherently more timely and compelling than mandatory disclosure documents because of the direct access they have to consumers, their expertise and resources in marketing/product design, and their increasing access to and sophisticated use of consumer data.

22 In this context, in ASIC's view, it is important to increase the expectation on the insurance industry to take an integrated approach to their product design, sales and marketing processes to improve understanding and outcomes for consumers.

B Comments on specific draft recommendations

Key points

ASIC supports:

- a requirement for insurers to provide consumers with an estimate of the sum insured;
- the establishment of a national home insurance comparison service informed by consumer research;
- provision of renewal notices no less than 28 days before policy expiry;
- more control for consumers in how claims are settled, and claims handling being included as a 'financial service' for the purposes of the Corporations Act; and
- clear disclosure by insurers of premium discounts that are applied to reflect risk mitigation measures taken by consumers, as well as further measures that could be taken and their effect on the premium.

Draft recommendation 1: Estimate of sum insured

23 ASIC supports the draft recommendation that insurers be required to estimate a sum insured for consumers; this would have a number of benefits.

24 Most importantly, we consider this recommendation could help to reduce the long-standing problem of underinsurance, which has been highlighted in several ASIC reports. For example, in September 2005, in Report 54 *Getting home insurance right—A report on home building underinsurance* (REP 54), we noted that underinsurance was initially recognised in Australia in the 1970s. Figures on the extent and degree of underinsurance quoted in the report included that structures destroyed in the bushfires in the Australian Capital Territory were underinsured on average by about 40% of the replacement cost.

25 REP 54 also noted that standard home building policies in Australia place the burden of estimating rebuilding costs on the consumer. It assessed this task to be intrinsically difficult, requiring technical knowledge and identified it as one of the reasons for underinsurance.

26 More recently, in Report 416 *Insuring your home: Consumers' experiences buying home insurance* (REP 416), published in October 2014, we referred to 2013 statistics from the Insurance Council of Australia that 'more than four in five Australian homeowners and renters (83%) are underinsured for their home and contents'.

27 Consumers interviewed as part of research conducted in preparing REP 416 used various unreliable techniques to estimate their sum insured. Most consumers ‘guessed’ the sum insured value, often using faulty assumptions. Some consumers were guided by the estimated market value of their homes in selecting a sum insured amount, some used original value and some estimated rebuilding costs based on their own family and friends doing the rebuilding.

28 REP 416 found that consumers often asked questions and sought assistance from insurers on how best to estimate the sum insured. However, because most insurers have adopted a ‘no advice’ or ‘factual information’ business model, they do not provide consumers with the information and/or advice needed. Requiring insurers to give consumers an estimate of the sum insured amount would alter this business model and help ensure that consumers receive the assistance they need. We expect that the estimate provided would generally be more accurate than the guesses often made by consumers.

29 REP 416 did find that some consumers used online calculators to help them choose a sum insured but the criteria used by these calculators were not transparent. When the calculator suggested an amount much higher than their usual sum insured, consumers experienced considerable dissonance, because accepting the suggested value meant increasing their premium.

30 The tendency was to resolve this dissonance by distrusting the insurer, assuming that the higher amount was a deliberate sales ploy to push up the premium, rather than an accurate reflection of current re-building costs. Because some consumers considered it unlikely they would ever need to claim on their building insurance, they gave very little thought to deciding on the sum insured for their building.

31 We expect that insurers would generally use their calculators and available property related data to determine the appropriate sum insured. This could involve the consumer providing relevant information to the insurer on the characteristics and features of their home which would also give the insurer an opportunity to explain the basis for the calculation. This two-way communication could help to build trust and reduce consumers’ tendency to assume that a higher-than-expected estimate represents a sales ploy.

32 REP 416 also found that consumers who tried more than one calculator discovered that the calculators varied in the value they calculated. These consumers therefore lacked confidence in the suggested amounts. We understand that such variations may reflect in part different cover provided for demolition, debris removal and professional fees between different insurance policies. Some insurers cover these costs over and above the sum insured amount while others cover them as part of the sum insured.

33 Requiring the insurer to estimate a sum insured for consumers would give the insurer an opportunity to explain any such variations between their estimate and those provided by other insurers. Doing so may help to improve consumer confidence in the estimates produced by the calculators.

34 It would also give insurers a greater incentive to work with third-party calculator providers to ensure the accuracy of the estimates produced—for example, by comparing the estimates provided with actual rebuilding costs following a total loss and providing this data to the providers. This would generate a feedback loop that may lead to ongoing improvements in calculator accuracy.

Draft recommendation 4: Home insurance comparison website

35 ASIC supports undertaking consumer research to identify the demand for and benefits to consumers of a national home insurance comparison website. Research should test whether a national home insurance comparison service would help consumers to identify insurers that offer relevant insurance products in their geographic area and compare those products to identify ones that meet their needs.

36 The research should help to identify the optimal features of such a website. As noted in the first interim report, such a website does create the risk that consumers will over-simplify their purchase decision by focusing on price rather than policy cover, terms and conditions. Minimising this risk would require careful and considered design of the comparison service. One way to manage this risk is to compare policies which offer standard cover.

37 If consumer testing supported this, such a comparison service could form part of ASIC's MoneySmart website which is an already-trusted source of information and a tool that was visited by almost 8 million people in 2018. Research previously conducted by ASIC indicates that independent government services/websites can help consumers to narrow their searches. This research, conducted for ASIC's MoneySmart website, found that such a service/website plays an important role in building consumers' confidence and knowledge.

Standard cover and standardised definitions of key terms

38 The risk of an over-emphasis by consumers on product price would be reduced if there were greater conformance by insurers with the standard cover regime and wider use of standardised definitions of key terms. We agree with the ACCC that these reforms would enhance the comparability of products and make a comparison service more effective.

39 ASIC has long supported the use of standardised definitions in insurance contracts, particularly for natural disaster risk. In a report published in June 2000, Report 7 *Consumer understanding of flood insurance* (REP 7), we identified that the lack of standardisation of the term 'flood' in home and contents insurance policies meant that consumers may not be aware whether they are covered for flood and, if they are, about the importance of the distinction between flood and other storm damage.

40 REP 7 recommended that insurers simplify and harmonise the drafting of insurance policies so that the availability or exclusion of flood insurance under home and home contents insurance policies was clarified. The confusion described in REP 7 was subsequently illustrated by issues that arose following the Queensland floods in 2010–11.

41 In REP 416, we reported on the findings of an online survey which asked consumers if they read or looked at the PDS when buying home building insurance. The findings in this report suggest that consumers know very little about the details of their home insurance policy. Some consumers did not know that policies differed but assumed that all home insurance policies were the same. They asked insurers few questions about their policy and did not think it necessary to read the PDS. Unless their insurer specifically told them otherwise, these consumers did not find out that policies can differ in their caps, limits and definitions of covered events.

42 In the absence of greater conformance with the standard cover regime and wider use of standardised definitions, consumers may use a comparison service to inadvertently select products that do not fully meet their needs or that may even be unsuitable for them (unless they engage closely with the details of each policy under their consideration, which the evidence suggests they are disinclined to do). Consumers who discover that the product does not meet their needs, potentially while making an unsuccessful insurance claim, may lose confidence in a comparison service.

43 ASIC’s position on standard cover and standardised definitions of key terms was most recently set out in our submission to the Treasury in response to the discussion paper, *Disclosure in general insurance: improving consumer understanding*. We have attached that submission for your reference.

Home building and home contents insurance

44 In any testing of the demand for a comparison website, there is merit in considering whether to include home contents insurance in addition to home building insurance as many consumers package their home and contents insurance together.

45 Consumers who struggle to obtain affordable home insurance cover because they live in a flood and/or storm prone area are also likely to have difficulty obtaining affordable home contents cover. Being able to compare both products is likely to make such a website more useful, although it would add to the complexity and cost of establishing and maintaining the website.

Live quotes compared to indicative prices

46 A comparison service that provides live quotes to consumers would appear to be significantly more useful to consumers than one that provides indicative

quotes only. This is especially the case if consumers can automatically proceed to product purchase after selecting from among the live quotes.

47 Offering only indicative quotes adds a layer of friction, requiring consumers to take an additional step to obtain a live quote directly from the insurer. Each added friction decreases the likelihood that the consumer will take the desired action.

48 Providing live quotes would also add the following dimensions to the establishment of a comparison service:

(a) consumers would need to provide all relevant underwriting information before a quote can be provided;

(b) any quotes provided by the comparison service would need to be honoured by the insurer with consequences applying where quotes are not honoured, as well as coverage by internal and external dispute resolution for aggrieved consumers to seek redress;

(c) insurers would need systems to provide information in real time to the comparison service operator;

(d) the service operator would need to have systems in place to keep consumer information secure and to protect insurers' commercially sensitive risk assessment and underwriting policy; and

(e) legislative change would be necessary for the independent operator of the service to require all insurers to provide information about their product offerings and agree to comparisons of their products being publicly displayed to consumers.

49 If insurers are required to provide a sum insured to consumers under draft recommendation 1 we expect that a consumer using the service would need to provide enough information for the insurer to calculate a sum insured amount rather than the consumer nominating a sum insured amount. Functionality to enable the sum insured to be calculated would need to be embedded within the website.

Participation of all relevant insurers

50 Requiring all active insurers who offer cover in a location (and all relevant insurance products) to be included in a comparison website would ensure that consumers are presented with a complete suite of product offerings from which to choose. It would also ensure that new market entrants are represented, with associated benefits for market competition.

51 Statutory powers would be needed to ensure the participation of all active insurers; these powers are not currently held by ASIC.

Rating system to facilitate product comparison

52 We agree that a rating system could be useful to consumers when comparing products and assessing the relative merits of the insurance policies they currently hold.

53 However, developing a rating system that benefits most or all Australians would be challenging given that each home has unique features including home size, build quality, features, location, condition and so on.

54 In contrast, greater compliance with the standard cover regime and a wider use of standard definitions would appear to represent a relatively straightforward means to enhance product comparability. These concepts are also familiar to and understood by the general insurance industry.

Website visibility

55 We agree that a comparison service must be visible to consumers to be useful. Achieving and maintaining such visibility would require ongoing promotion of the website similar to commercial comparison services and sufficient funding specifically for this purpose.

Other considerations

56 ASIC's submission to the Senate Economics References Committee Inquiry into Australia's general insurance industry identifies other considerations that could inform a decision by the ACCC on whether to recommend establishment of a national insurance comparison website.

Draft recommendation 5: Renewal notices giving 28 days' notice

57 ASIC supports the draft recommendation for renewal notices to give 28 days' notice. However, we think that insurers should also send a further follow-up notice if the policy is not renewed after 14 days. We agree that this would give consumers more time to consider their insurance options.

58 This recommendation would support other efforts aimed at encouraging consumers to engage more closely with their insurance decisions at policy renewal including by providing additional time to shop around.

Draft recommendation 11: Consumer choice in claims settlement

59 ASIC supports the draft recommendation that consumers should have more control over how claims are settled.

60 We agree that consumers should have the right to choose whether a claim is settled with a cash settlement or with a repair or rebuild by the insurer. We

also agree that consumers should be given clear and effective notices about the implications of accepting a cash settlement—for example, that the insurer will be discharged of any obligations to manage or guarantee the quality, cost or timeliness of any repair the consumer chooses to undertake.

61 We recognise that there may be some very limited circumstances where it is necessary for an insurer to provide a cash settlement—for example, when a consumer wants a repair or rebuild that is outside the policy coverage.

62 We consider that these changes would address some of the issues associated with claims settlement that were highlighted in evidence during Round 6 of the Royal Commission. Most notably, cash settlement offers can reflect the lowest quote in circumstances where:

(a) the quotes may vary widely;

(b) the quotes received by the insurer are not disclosed to the insured, and

(c) because of the insurer’s purchasing power, the quotes available to the insurer are considerably lower than those the consumer can obtain independently.

Note: This last point is particularly relevant after catastrophe events when the high demand for building services increases prices (‘demand surge’).

63 We also consider that insurers should mandate industry standards in the General Insurance Code of Practice for cash settlement practices. This would include requiring insurers to give consumers a copy of all quotes that the insurer receives when determining the cash settlement amount, allowing the consumer to obtain and submit their own quote to be considered as part of any cash settlement process, and ensuring there is prompt, consistent and effective communication throughout the claims handling process.

Draft recommendation 12: Clearly stated mitigation discounts

64 ASIC supports the draft recommendation to require insurer quotes and renewal notices for a property to disclose what, if any, premium discounts have been applied to reflect risk mitigation measures taken on that property.

65 In supporting this recommendation, we have taken into account the limitations of relying on disclosure discussed earlier in this submission, and that insurers should be looking for further ways to use targeted communications to ‘nudge’ consumers to take mitigation measures.

66 We agree that this would help ensure premium adjustments are comparable between insurers and provide clarity to consumers. We also agree that it would help to give consumers confidence that taking mitigation measures can lead to a reduction in premiums. Such confidence is essential for consumers to invest in these types of measures.

Draft recommendation 13: Risk mitigation to reduce premiums

67 ASIC agrees that it is important that all insurers establish a mechanism under which homeowners who take effective risk mitigations measures are rewarded with a pre-determined insurance premium reduction. We understand that some insurers may already do so.

68 We agree that the specific mitigation measures affecting the premium should be those that are demonstrated to be effective in reducing risk. Insurers are much better placed than consumers to understand what these measures are. Many consumers are unaware of the specific measures they can take to reduce their risks and even if they are aware, many may not be confident that taking those measures will lead to lower insurance premiums.

69 Further, only insurers can quantify the effect that specific mitigation measures would have on an insurance premium. We think it is essential that insurers also be required to quantify this effect transparently and in a way that gives confidence to consumers. It is also essential that consumers be assured that if they do decide to invest in mitigation measures, they will receive the premium reductions advised by their insurer.

70 If these disclosures are made and the disclosed premium reductions honoured by insurers, consumers are likely to use this information to help reduce their premiums. Such a mechanism would help to make insurance more affordable for some consumers, particularly in areas where affordability has proven challenging, such as in northern Australia. Reducing risks through consumer-initiated mitigation measures would also benefit general insurers by reducing their risk exposures.

71 As currently constructed, the draft recommendation places heavy emphasis on the need for improved disclosure. However, given the inherent limitations of disclosure we suggest that the recommendation be reframed to emphasise the need for a direct mechanism linking effective mitigation measures with premium reductions, as discussed above. We would support a recommendation that took this form.

Monitoring of implemented recommendations

72 We suggest that if the draft recommendations are formally recommended to the Government and implemented, they should be subject to monitoring and testing to assess their effectiveness in achieving their intended purpose and to identify any unintended consequences, or areas for improvement.

Key terms

Term	Meaning in this document
ACCC	Australian Competition and Consumer Commission
ASIC	Australian Securities and Investments Commission
ASIC Act	*Australian Securities and Investments Commission Act 2001*
Corporations Act	*Corporations Act 2001*, including regulations made for the purposes of that Act
first interim report	The first interim report of the Northern Australia Insurance Inquiry issued by the ACCC in November 2018
Government	Australian Government
insurer	An insurance company authorised by the Australian Prudential Regulation Authority to conduct new or renewal insurance business in Australia
Key Facts Sheet	A disclosure document containing specified information that must be provided for a home loan or credit card offer under the *National Consumer Credit Protection Act 2009*
policy	An insurance contract
Product Disclosure Statement (PDS)	A document that must be given to a retail client in relation to the offer or issue of a financial product in accordance with Div 2 of Pt 7.9 of the Corporations Act Note: See s761A for the exact definition.
REP 54 (for example)	An ASIC report (in this example numbered 54)
Royal Commission	Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry
s761A (for example)	A section of the Corporations Act (in this example numbered 761A)
unfair contract protections	The unfair contract provisions in the ASIC Act relating to standard form consumer contracts for financial products and services, which have also applied to standard form small business contracts since 12 November 2016 Note: See Div 2 of Pt 2, Subdiv BA of the ASIC Act

Disclosure in general insurance: Improving consumer understanding

Submission by the Australian Securities and Investments Commission

March 2019

Contents

Executive summary

1 The Australian Securities and Investments Commission (ASIC) welcomes the opportunity to provide comments on proposals raised in Treasury's discussion paper, *Disclosure in general insurance: Improving consumer understanding* of January 2019.

2 The strength of the evidence about the limitations of disclosure indicates that it is important to move beyond a presumption that disclosure is always the right, default, or only, regulatory tool to address issues of concern in the general insurance market. Disclosure will continue to have a role, but it is important that its effectiveness not be over-stated and that it is complemented by the development and employment of more effective regulatory tools.

3 The insights and recommendations of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services provide an opportunity to refocus from an over-reliance on disclosure to fix problems resulting from misaligned incentives and poorly designed products.

4 In particular, the proposed product design and distribution obligations will provide increased accountability for issuers and distributors across the product life cycle, rebalancing the responsibility for product suitability decisions between consumers and industry. Together with the proposed product intervention power, these reforms will allow ASIC to take a broader regulatory approach beyond disclosure-based interventions to improve consumer outcomes.

5 To maximise the opportunity afforded by these new powers, ASIC considers it important that they be prioritised in the Government's reform agenda, along with the proposed application to insurance contracts of the unfair contract provisions in the *Australian Securities and Investments Commission Act 2001*.

6 The Financial System Inquiry (FSI) gave the general insurance industry the task of reducing complexity and improving consumer understanding. Progress made since this issue was flagged in 2014 has been modest. The question for the insurance industry becomes how it can move beyond 'innovative disclosure' initiatives, and take an integrated approach to product design, sales and marketing processes to improve the understanding and outcomes of its customers.

7 As an initial step for improved product design, ASIC considers that insurers should offer products that provide standard cover. This could be done while insurers continue to offer existing products that diverge from standard cover. Such an approach would enable consumers to access the benefits of the standard cover regime and provide them with greater certainty.

8 Notwithstanding the limitations of disclosure, ASIC supports disclosing the previous year's premium on renewal notices. This would encourage competition and comparability and allow transparent price comparisons.

9 ASIC also supports greater standardisation of definitions of key terms. This is expected to improve consumer outcomes by minimising the likelihood of consumer confusion.

A The limitations of disclosure

Key points

Evidence shows that disclosure documents do not improve consumer decision-making, help with product comparisons or prevent consumers buying unsuitable products.

Insurers must therefore go beyond 'innovative disclosure' initiatives and integrate product design, sales and marketing processes to improve consumer understanding and outcomes.

Rationale for ASIC's approach to disclosure

10 In ASIC's view, while disclosure is important, generally too much weight is put on disclosure to address problems it alone cannot fix, including those resulting from competition failures, misaligned incentives and poorly designed products.

11 If well designed, disclosure can, for example, contribute to market transparency and efficiency, provide information that is valuable to the private sector and to regulators, facilitate innovative development of private sector applications or tools, and act as a post-purchase reference document for consumers in the event of a dispute.

12 However, we do not consider it is sufficient on its own to protect consumers or drive competition in insurance. Disclosure should be complemented by the development and use of more effective regulatory tools.

Evidence of the limitations of disclosure

13 There is now a strong body of evidence concluding that mandatory disclosure documents (including even shorter, graphic or 'improved' disclosures) do not generally enhance consumer decision-making, help consumers to make real-time comparison of products and services to their benefit, or prevent them from actively avoiding unsuitable products.

Note: See, for example, Omri Ben-Shahar and Carl E. Schneider, *The failure of mandated disclosure*, 159 University of Pennsylvania Law Review 687, 2011; T. Gillis *Putting disclosure to the test: Towards better evidence-based policy*, 2015, p. 47.

14 In ASIC's regulatory experience:

(a) disclosure has not been a brake or constraint on the sale of unsuitable insurance products (including products that consumers are ineligible to claim under);

(b) disclosure has not prevented unfair sales where consumers have been unaware that they have purchased insurance products, the price of those products and/or the risks covered by the products; and

(c) some consumers have poor or no recall of receiving disclosure documents before purchasing insurance products.

Note: See, for example, ASIC's Report 7 *Consumer understanding of flood insurance* (REP 7), Report 416 *Insuring your home: Consumers' experiences buying home insurance* (REP 416) and Report 470 *Buying add-on insurance in car yards: Why it can be hard to say no* (REP 470).

15 Some of the limitations of disclosure that ASIC has identified that help explain these failings include the following:

(a) *Disclosure is generalised*—It is not designed to maximise a consumer's understanding of the product as it applies to them individually and fails to account for the fact that any one piece of information is used and understood differently from person to person and situation to situation.

(b) *Disclosure typically occurs at a time when it is unlikely to be relevant to consumer decision making*—For example, disclosure may occur after the consumer has already made the decision to purchase the product—and all forms of disclosure compete with more compelling and timely influences (e.g. sales staff, advertising and friends and family).

Note: These limitations are more pronounced when the product is sold under a general advice model, when the salesperson can promote the benefits of the product irrespective of whether it meets the consumer's needs.

(c) *Financial products are inherently complex*—This is particularly the case where the consumer needs to assess risk, probability and the uncertain future performance of the product on the basis of limited information and with innately constrained cognitive capacity. Strategic product complexity and sales techniques (e.g. bundled products and pricing, confusing and opaque 'discounts', unclear fee descriptors) can defeat consumer attempts at understanding even simplified disclosures.

Over-reliance on disclosure and the role of the insurance sector

16 A heavy reliance on disclosure places the onus on the consumer to protect themselves and drive a fair and well-functioning insurance sector. ASIC considers that this burden on consumers is inconsistent with recognised research and knowledge about consumer behaviour and permits market conduct that is inconsistent with community expectations.

17 In general, disclosure-based approaches rely on assumptions that are at odds with how people actually do and can behave in many decision-making contexts in financial markets. These assumptions include that:

(a) disclosure will be effective in overcoming limitations in consumer understanding and behavioural biases; and

(b) consumers will use information optimally in a narrow instrumental sense, they are not prone to decision biases, and they have the ability to undertake complex comparisons and calculations.

18 These assumptions also fail to adequately take into account the extent to which firms with misaligned incentives can put in place supply side barriers to a fair, well-functioning insurance sector—for example, by creating or taking advantage of consumer confusion and subtly nudging consumers towards product purchases and uses that further commercial rather than consumer interests.

19 Insurers and distributers are well positioned to influence consumers and their communications are inherently more timely and compelling than mandatory disclosure documents because of:

(a) the direct access they have to consumers;

(b) their expertise and resources in strategic marketing/product design; and

(c) their increasing access to and sophistication in use of consumer data.

20 In this context, it is important to increase the expectation to go beyond ‘innovative disclosure’ initiatives, and take an integrated approach to product design, sales and marketing processes to improve the understanding and outcomes of customers.

B Specific proposals

Key points

ASIC supports:

- disclosing the previous year's premium on renewal notices;
- consumer testing of different forms of component pricing disclosures to better assess consumer benefits;
- mandating that where an insurer chooses to offer products in a class of insurance subject to the standard cover regime that at least one of those products offer standard cover; and
- greater standardisation of definitions of key terms.

Disclosing the previous year's premium on insurance renewal notices and explaining premium increases

21 Notwithstanding the limitations of disclosure, ASIC supports disclosure of the previous year's premium on insurance renewal notices.

22 We consider that this would encourage competition and comparability and allow transparent price comparisons to be made by consumers. The requirement should apply to all general insurance policies that are subject to annual renewal including car and home insurance products.

23 The use of renewal notices to convey this information is supported by disclosure research commissioned by the Insurance Council of Australia (ICA), which found that:

> The renewal letter was the most commonly relied on source of information pre-purchase for car and home insurance policies and was almost always the highest rated information source.

> Note: See ICA, Consumer research on general insurance product disclosures, Research findings report, February 2017, p. 34.

24 Although some insurers may elect voluntarily to display last year's premium on renewal notices, legislative change would be required to compel all insurers to do so and ensure the disclosures are made in a consistent and comparable way.

25 The discussion paper refers to experience in the United Kingdom where the Financial Conduct Authority (FCA) introduced new rules to increase transparency and engagement at insurance renewal. ASIC notes that in a 2015 press release, the FCA stated:

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

> Note: See FCA, *FCA to require insurance firms to publish details of last year's premium*, Press release, 3 December 2015.

26 As noted in the discussion paper, experience in the United Kingdom included a degree of non-compliance with the new requirements. This included a failure by some insurers to convey the information on renewal notices in a manner that drew the consumer's attention.

27 Given this international experience, it is important that the legislated requirements to disclose the information also specify the precise form, content and placement of the disclosures. This will better ensure that the requirement is effective and will help enforce it. It is important that consumer testing be conducted to confirm the optimal form, content and placement of the disclosures.

28 The discussion paper indicates that there now appears to be broad industry support for disclosure of the past year's premium and that industry has agreed to amend the General Insurance Code of Practice to require the disclosure of the previous year's premium at renewal for home insurance policies.

29 ASIC also supports introduction of a requirement that insurers explain premium increases when a request is received from a policyholder.

30 We consider that this will better inform the consumer about the underlying reasons for premium increases and help them in deciding whether to shop around for alternative policies. It may be more effective in this regard than providing the consumer with a simple reminder to shop around. ASIC is confident that the general insurance industry can overcome any practical difficulties in providing information on the reasons for premium increases.

31 The discussion paper indicates that the ICA supports insurers providing consumers with the reasons for premium increases.

32 ASIC provides the following comments in response to selected questions in the discussion paper.

Question 8. Where the previous year's premium is disclosed, should it be just the premium, or should it include taxes and charges? Should the amount of the insured value for the previous year also be disclosed?

33 The disclosure of the previous year's premium should take the form that best allows direct comparison with the current year's quoted premium, as well as insurance quotes obtained from other insurers. The disclosure should also include the previous year's sum insured amount.

Question 10. Would the inclusion of the sum insured and any excess along with previous year's premium on renewal notices be more appropriate than only disclosing previous year's premiums?

34 ASIC supports the inclusion of the sum insured and any excess on renewal notices, in addition to the previous year's premium, as this additional information should help the consumer to compare the insurance offer.

Question 11. What are the benefits and costs in mandating a link to the ASIC's MoneySmart website to be included in new quotes and renewal notices?

35 ASIC recommends that consumer testing be conducted to inform any decision to include a link to the ASIC MoneySmart website in new quotes and renewal notices and to help maximise the effect of such a requirement.

Disclosing component pricing

36 ASIC supports measures by insurers to better inform consumers of the practical strategies they could implement to address their personal risk and the extent to which doing so would reduce their insurance premiums.

37 Such information is needed to enable consumers to conduct a cost-benefit analysis of various risk mitigation measures. It is also needed to provide consumers with the confidence necessary to invest financially in mitigation measures in the knowledge that doing so will reduce their risks and their insurance premiums.

38 ASIC understands that the Financial System Inquiry recommended disclosure of component pricing to improve the transparency of general insurance pricing. The Financial Rights Legal Centre had suggested to the Inquiry that this approach could inform consumers about what effect mitigation strategies may have on their premiums.

39 We consider that disclosing component pricing in insurance quotes may also better inform consumers when shopping around for insurance.

40 ASIC suggests that further consideration is needed to assess the various costs and benefits of disclosing component prices. We think this should include consumer testing of various forms of component pricing disclosures on renewal notices and insurance quotes.

Standard cover

41 ASIC agrees that the standard cover regime is not achieving its intended purpose to set out the minimum requirements for prescribed types of insurance contracts. However, this is not due to shortcomings in the concept of standard cover itself. On the contrary, standard cover has the potential to deliver significant benefits to consumers. Nor is it due primarily to deficiencies in the efficacy of the current disclosure requirements.

42 Rather, it is the result of a deliberate decision by insurers to circumvent the regime and not offer standard cover. This is made possible by a feature of the regime that enables insurers to avoid its requirements simply by disclosing deviations from standard cover in the Product Disclosure Statement (PDS). Insurers are even permitted to make such disclosures up to 14 days after the consumer has entered into the insurance contract, in certain circumstances.

43 This effectively prevents many consumers from gaining the benefits of standard cover. But it also makes it unlikely that most consumers would even be aware of the existence of standard cover or that the insurance cover they have purchased may fall short of it.

44 ASIC considers that there is a need to strengthen the standard cover regime and to do so in a manner that is most effective in delivering the benefits of the regime to consumers.

45 We therefore recommend that it be mandated that where an insurer chooses to offer products in a class of insurance subject to the standard cover regime that at least one of those products offer standard cover. Products that provide standard cover should be labelled as doing so in a manner that avoids any doubt among consumers.

46 This approach would enable consumers to readily access the benefits of the standard cover regime and provide greater certainty for consumers while also enabling some consumers to purchase products that offer either greater or lesser cover depending on their individual circumstances and needs.

47 ASIC also recommends that the standard cover regime be extended to other insurance products such as gap insurance to ensure the regime reflects the wider range of product offerings now available.

Standard definitions

48 ASIC supports greater standardisation of definitions of key terms used in general insurance contracts.

49 In our view, this is likely to improve consumer outcomes by minimising the likelihood of consumer confusion.

50 ASIC has long supported the use of standardised definitions in insurance contracts, particularly for natural disaster risk. An early report, ASIC's Report 7 *Consumer understanding of flood insurance* (REP 7), identified that the lack of standardisation of the term 'flood' in home and contents insurance documents meant that consumers may not be aware whether they are covered for flood and, if they are, about the importance of the distinction between flood and other storm damage.

51 REP 7 recommended that insurers simplify and harmonise the drafting of insurance policies so that the availability or exclusion of flood insurance under home and home contents insurance policies was clarified. The confusion described in REP 7 was subsequently illustrated by issues that arose following the Queensland floods in 2010–11.

52 The discussion paper refers to industry remarks that the use of standard definitions could result in insurers offering the same cover, thereby reducing consumer choice. ASIC suggests that there is some doubt as to whether most consumers are even aware that such a 'choice' exists or whether it provides any genuine benefit to them.

53 ASIC's Report 416 *Insuring your home: Consumers' experiences buying home insurance* (REP 416) reported the findings of an online survey which asked consumers if they read or looked at the PDS when buying home building insurance. The findings of this survey are instructive given that careful reading of PDSs would be almost essential to identifying and understanding differences in definitions.

54 The survey found that only two in every ten consumers (20%) who took out new insurance or considered switching did read the PDS. Even then, the accompanying qualitative research found that 'reading' the PDS generally meant reading selected pages, not all of it.

55 The findings in REP 416 suggest that consumers know very little about the details of their home insurance policy. Some consumers did not know that policies differed as they assumed that all home insurance policies were the same. They therefore asked insurers few questions about their policy and did not think it necessary to read the PDS. Unless their insurer specifically told them otherwise, these consumers did not find out that policies can differ in their caps, limits and definitions of covered events.

56 These findings suggest that rather than being able to take advantage of the choice offered by differing definitions, many consumers are unaware that definitions can differ. Meanwhile, the risk that consumers are taking decisions based on a mistaken belief that definitions are the same may outweigh any benefits.

Facilitating product comparison

57 In addition to the points made above in support of standard cover and the wider use of standard definitions, ASIC considers these reforms are also needed to better enable consumers to compare insurance products.

58 We are aware of calls for the introduction of a general insurance comparison website, including by the Senate Economics References Committee itself, which recommended that the Government complete a detailed proposal for an online comparison tool for home and car insurance.

Note: See Senate Economics References Committee report, *Australia's general insurance industry: Sapping consumers of the will to compare*, August 2017, Recommendation 8.

59 For any such comparison website to be effective, it would need to allow consumers to directly compare like-with-like products. Consumers would also need to have confidence that the products they are comparing on the website do offer the same type of cover. If such confidence is lacking, the website may be unsuccessful.

60 The standard cover regime and a wider use of standard definitions would appear to represent relatively straightforward means to enhance product comparability. They are also familiar to the general insurance industry.

61 In this regard, we note that in its draft recommendation on a national home insurance comparison website, the Australian Competition and Consumer Commission (ACCC) identified standard cover and standard definitions as being of assistance in improving the effectiveness of such a comparison tool, as follows:

> **Draft recommendation 4: National home insurance comparison website**
>
> The government should consider developing a national home insurance comparison website. It should require the participation of all insurers active in relevant markets, allow consumers to compare policies by features, and make it quick and easy for consumers to act on the results.
>
> Enhanced comparability of products, such as through *standardised definitions*…and *mandated standard cover*…*will assist in the effectiveness of such a website*. (emphasis added)

Note: See ACCC, Northern Australia Insurance Inquiry, First interim report, November 2018, Draft recommendation 4.

62 ASIC recommends strengthening the standard cover regime and the greater standardisation of definitions of key terms due to the direct benefits that doing so will provide to consumers. However, we agree with the ACCC that these reforms would also help to improve the effectiveness of a national insurance comparison website, if it was established.

Review of the Key Facts Sheet

63 The Monash University research referred to in the discussion paper provides evidence about limitations on the effectiveness of Key Fact Sheets. The research examined the effectiveness of home contents PDSs and Key Facts Sheets in helping consumers to select the policy that best suited their needs.

64 The research found that:

> *despite ideal and simplified conditions*, up to 42% of participants chose the worst offer, despite being given the time and opportunity to review the disclosure information. When able to choose from three policies, 35% chose the worse policy and only 46% found and selected the best policy. *There was no simple and consistent effect of disclosure—while participants were more likely to forego purchasing an insurance policy when they had only access to the PDS the results did not find a clear pattern of understanding where people were provided more or less disclosure information*. Purchasing decisions were not affected by the way in which the consumer viewed the disclosure (i.e. computer or smart phone). (emphasis added)

Note: See J. Malbon and H. Oppewal, Monash University, Melbourne, *(In)effective disclosure: An experimental study of consumers purchasing home contents insurance*, research report of a study commissioned by the Financial Rights Legal Centre, 2018.

65 ASIC notes that this research is predated by the recommendation to review the utility of the Key Facts Sheets in the 2017 report by the Senate Economics References Committee into the general insurance industry.

Note: See Senate Economics References Committee, *Australia's general insurance industry: sapping consumers of the will to compare*, August 2017.

66 The utility of Key Facts Sheets may be enhanced with the introduction of standard cover and a broader range of standard definitions.

A modern approach to disclosure

67 In considering a modern approach to disclosure, it is important to keep front of mind the risks as well as the opportunities associated with the digital forms of disclosure that are typically characterised as being ‘innovative’, with the risks more acute when firm incentives are out of alignment with their customers.

68 The potential negative impact of modern technology on attention and information processing is particularly relevant. For example, consumers interpret and engage with digital information in a different way to offline information, and process information differently across different digital devices. They process information on screens at faster speeds and can be more likely to skim read and rush their thinking.

69 This tendency can be even stronger with small devices such as mobiles. Attention can be especially short on digital devices (e.g. when people are ‘on the go’, or in a hurry), increasing the chance that rushed or shallow thinking and visual biases will affect their decisions as shown in the Monash University research.

Key terms

Term	Meaning in this document
ACCC	Australian Competition and Consumer Commission
ASIC	The Australian Securities and Investments Commission
discussion paper	*Disclosure in general insurance: Improving consumer understanding*, issued by Treasury in January 2019
FCA	Financial Conduct Authority (UK)
guaranteed asset protection (GAP) insurance	General insurance that covers the difference between the amount a consumer owes on their car loan and any amount they receive under their comprehensive insurance policy, if the car is a total loss
ICA	Insurance Council of Australia
inquiry	The Senate Economics References Committee Inquiry into Australia's general insurance industry
insurer	An insurance company authorised by the Australian Prudential Regulation Authority to conduct new or renewal insurance business in Australia
Key Facts Sheet	A two-page document, required by the Insurance Contracts Regulations, summarising key information about a home building and/or home contents policy
policy	The insurance contract
Product Disclosure Statement (PDS)	A document that must be given to a retail client in relation to the offer or issue of a financial product in accordance with Div 2 of Pt 7.9 of the *Corporations Act 2001* Note: See s761A of that Act for the exact definition.
REP 7 (for example)	An ASIC report (in this example numbered 7)