

Submission to the Treasury's consultation on Standard definitions and standard cover for insurance

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About Financial Counselling Victoria and the financial counselling sector

Financial Counselling Victoria (FCVic) is the peak body and professional association for financial counsellors in Victoria. We provide resources and support to financial counsellors and their agencies who assist vulnerable Victorians experiencing financial difficulty. We work with insurers, governments, banks utilities, debt collection and other stakeholders to improve approaches to financial difficulty for vulnerable Victorians.

Financial counselling is a free, confidential, and independent service. It provides vital help for people experiencing, or at risk of, financial hardship. Financial counsellors are uniquely qualified professionals, specially trained to deal with complex financial matters. They assist more than 23,000 Victorians each year – including newly arrived migrants and refugees, family violence victim-survivors, and particularly pertinent to this submission, people impacted by catastrophic natural disasters.

In recent years, communities across Victoria have been dealing with the aftermath of catastrophic disasters, ranging from devastating bushfires to destructive storms and floods. Financial counselling services have played a vital role in aiding the financial recovery and physical wellbeing of impacted individuals and communities.

While the impacts are experienced most severely by vulnerable and less resilient communities, households and individuals whose capacity to recover is lower, disasters create financial stress and hardship that can affect anyone, including people who have not previously needed assistance. Disasters can exacerbate underlying or unaddressed financial issues which may have been present prior to the disaster, and those financial impacts can be experienced for many years after the event.

Financial counsellors working in this space have highlighted a wide range of insurance-related issues which have caused significant detriment and additional trauma to their clients following their experiences of natural disasters, specifically in relation to *fair* and *reasonable* outcomes to insurance claims and the accessibility of insurance.

About this submission

We welcome the opportunity to provide a submission to Treasury's consultation on Standard definitions and standard cover for insurance. Our submission focuses on areas that are relevant to our advocacy work on post-disaster insurance issues in Victoria and is informed by what our members have told us about the needs of vulnerable Victorian clients who are struggling with these insurance issues after a natural disaster.

Further questions about this submission can be sent to achan@fcvic.org.au.

Our commentary and recommendations

We note that changes to the standard definitions and cover for insurance will simply ‘tinker on the edges’ of a much larger question – whether property insurance in its current format is fit for purpose and adequately protects the most vulnerable particularly in the aftermath of a major-loss disaster.

We suggest that the health and wellbeing role played by insurance in protecting communities and enabling recovery and resilience should be considered an essential service and supported where there is a service and equity gap to manage risk and deliver ongoing public and economic benefits to the community and local small business economies.

Simply changing definitions and cover will not address this ever-increasing gap.

However, given our understanding that addressing this larger structural question is outside the remit of this consultation, we have provided specific feedback to several of the consultation questions below.

Firstly, we note the excellent work done to date by the Financial Rights Legal Centre (FRLC) in their March 2022 report ‘Standardising general insurance definitions’ <<https://financialrights.org.au/publication/standardising-general-insurance-definitions>> and support and reiterate all seven recommendations of this report as part of our submission.

1. To what extent is consumer misunderstanding of insurance policies leading to unintentional underinsurance or inappropriate insurance?

Financial counsellors report evidence of widespread consumer misunderstanding of insurance policies (e.g. product disclosure statements) which result in detrimental outcomes in the event of needing to make an insurance claim or even choosing an appropriate policy from the outset. We have grouped common misunderstandings under the following sub-headings below – policy wording, amount of insurance, and insurance settlements.

Policy wording

- The differences between a ‘replacement policy’ and a ‘sum insured policy’, and the benefits and disadvantages of each.
- Policy-holder obligations, including around clauses relating to ‘adequate’ home maintenance as buildings depreciate.
- What parts of a house are or are not covered as part of a policy – e.g. stumps.
- Referencing FRLC’s report, the ‘confusopoly’ of clauses that are worded differently across different products.
- Exclusions buried in the body of the policy, for example, where following a bushfire, burnt property is covered but heat related damage (melting) is not.

Amount of insurance

- Whether the sum insured will cover a house rebuild (including to higher building standards) as well as associated costs such as debris removal, temporary accommodation, outbuildings and fences, and remediation of subsequent resulting damage such as mould.

- That insurers don't pay out the full sum insured as paid for in their premiums, if less is ultimately required to fix the property.
- Lack of knowledge about cost of future mitigation measures (including those over and above replacement building standards) that should be included in any policy calculation for a rebuild as part of ongoing efforts by households to improve the climate resilience of their homes (e.g. Bushfire Attack Level rating requirements and 'Build Back Better' flood adaptation).

Insurance settlements

- The consequences of cash settlements including the transfer of risk to the insured and loss of insurers' lifetime warranty on work.
- That the cash settlement offered may be costed at the insurers' contractor rate and not cover local actual trade costs.

While individually these common misunderstandings are concerning in themselves, combined, they create a particularly problematic environment where insurance as it currently stands is not accessible or comprehensible to the average consumer. Nor, increasingly, is it adequate. In cases, it is further traumatising for consumers when discovered following a catastrophic event. These challenges are amplified for vulnerable households who face disadvantages in navigating these issues, particularly low literacy or where English is a second language.

Additionally, we must consider that inappropriate coverage is also increasingly being driven by affordability issues, which must be addressed alongside issues around misunderstanding. In cases where people on pensions face the option of paying \$40,000 for home insurance that includes flood cover or living without insurance (potentially in mortgage default, but unable to sell), the choice is clear. This insurance affordability gap and climate-resilience of housing stock must be addressed.

2. What are the consequences of not addressing these issues?

The negative consequences of not addressing these critical issues fall predominantly upon the consumer and can create negative financial impacts that last for many years after the incident.

The '10 Years Beyond Bushfires Report' showed that nearly a quarter of residents impacted by the 2009 Black Saturday Bushfires were still experiencing financial stress five years after the event, and our experience through more recent disasters (2020 Black Summer Bushfires) has shown that it can take years before the financial impacts of a disaster event are fully apparent, with only 25% having rebuilt in some regions by the end of 2023.

Financial counsellors report that some common consequences for consumers may include:

- Ending up with a cash settlement that is significantly less than the cost of rebuilding their home as it was
- Months or years-long disputes with insurers relating to clauses within their policy, resulting in further deterioration of property
- Unable to complete necessary upgrades of the climate resilience of their homes due to poor insurance coverage

- Simply being unable to rebuild at all

All the negative consequences listed above can result in increased social and community demand on homelessness and housing supports, health and mental health care, family violence interventions, community wellbeing supports such as financial counselling, and more. Additionally, caseload waiting lists have blown out with the Australian Financial Complaints Authority, and community lawyers dealing with insurance disputes.

In this sense, the private market of insurance is creating real demand on Australia's social support system as insurers obfuscate their offerings and exclusions to minimise claim outlays, and confound consumers from making informed choices between providers or to fully comprehend the limitations available.

3. Aside from reviewing standard cover and standardising common terms, what other interventions may increase consumer understanding of insurance cover and reduce underinsurance or inappropriate insurance?

We suggest that the following interventions be considered to address some of the insurance issues mentioned in the responses above.

Component pricing, regulated by a dedicated pricing regulator

Component pricing whereby insurers are required to provide a transparent breakdown of all insurance premium pricing will assist consumers to make better informed decisions about their insurance policies and undertake any required risk mitigation that may help to adjust their existing policy premiums.

Transparency through detailed premium price breakdowns will always promote greater consumer understanding of their insurance cover. It will also allow more capable consumers to compare policies from different insurers more easily, providing greater control and autonomy.

Standard insurance contract required to be sold by all insurers

Standardising a basic and consistent insurance contract that is required to be sold by all insurers, similar to the existing use of standard residential tenancy agreements or builders agreements, will make it easier for consumers who buy insurance cover to understand their baseline of protection, regardless of their level of literacy or capability.

We suggest that costing for this standard insurance contract should use a consistent formula, with variables depending on property size, materials, and the like. Combined with component pricing, this will allow savvy consumers to shop around and find a suitable level of cover for their individual circumstances.

Commitments to 'building back better'

Rebuilding or repairing a home to the same specifications as prior to a natural disaster is a poor insurance policy decision that is likely to lead to adverse outcomes in the future as natural disasters increase in both number and magnitude. The concept of 'building back better' is not new and should be standardised in insurance policy wording as a safeguard for insurers, consumers and communities, understanding that this may affect policy costs in the short-term (something a Mortgagee may assist with), but reduce recovery costs in the long-term.

We suggest that this wording be included in the standard insurance contract recommended above, and be required for all insurance policies sold for homes in designated flood and bushfire zones. This should capture at a minimum, established Standards such as the ABCB Standard for Construction of buildings in flood hazard areas, as well as 'common sense' measures relating to foundation work and internal fittings.

These wording changes to insurance policies must be accompanied by related legislation, financial investment, and planning decisions to minimise impacts of future disasters, ensuring that we build back better as a community.

Guidelines to establish if an insured is capable of undertaking a rebuild if offering a cash settlement

Currently, FCVic hears reports of insurers offering inadequate cash settlements to clients who are not capable of project-managing repairs to their home, let alone total rebuilds.

In one instance, an insurer offered a \$24,000 cash settlement to an 81-year-old pensioner to cover repairing flood damage to the home. A financial counsellor managed to negotiate on the client's behalf to secure a \$193,000 cash settlement, as well as accommodation while the house is repaired – a clause that was in the original insurance policy, but never communicated to the client.

It's evident that without the intervention of a financial counsellor, this pensioner would have been left with a cash settlement offer that was entirely inadequate for his needs to undertake home repairs.

We recommend that guidelines be established for insurers on a requirement relating to the assessment of client capacity to self-manage home repairs or rebuilds prior to the offer of a cash settlement. This may include assessments of personal family and friend support networks, access to professional assistance such as financial counselling, levels of literacy, financial position, and more.

Where cash settlements are deemed to be appropriate by an insurer, these should be offered in writing, unredacted, with a component breakdown summarising how the insurer calculated the final amount offered. This should also include standardised wording about the client's options to dispute the amount offered through both internal and external dispute resolution channels.

4. Do you agree with the priority terms that are proposed for standardisation (fire, storm, stormwater, and rainwater run-off)?

Yes, we agree that these terms should be standardised, and also including what these terms are *not* (e.g. sea inundation, riverine floodwater, etc.). Further, we recommend that the standardisation of these terms should consider broader consumer understandings of the meanings of these terms, rather than a strict insurance understanding.

For instance, reflecting on the relevant passage in the consultation paper, we believe that the term 'fire' should encapsulate not only actual fire damage, but related damage including smoke, ash, heat and melting. This broader definition is more in line with what consumers would anticipate 'fire' to cover, and will therefore prevent consumer misunderstandings around insurance cover.

7. How well is the current standard cover regime achieving its intended purpose?

High levels of unintentional underinsurance suggest that the standard cover regime is not achieving its intended purpose. Although there is no formal data available on this, unintentional underinsurance is reported by financial counsellors to FCVic as the single biggest issue that they engage on in post-disaster contexts.

Unintentional underinsurance leads to a range of poor consumer outcomes, including long and expensive claim disputes during which the individual is usually living in sub-standard accommodation, and the inability to rebuild or repair homes to the same or better standard. These poor experiences with insurers can lead to poor mental health outcomes, representing ongoing pressures on the Australian health system.

A stronger standard cover regime, such as in which each insurer is required to provide the standard product (see above recommendation on a standard insurance contract), would reduce such unintentional underinsurance by developing better consumer understanding of what the baseline product is and therefore how other policies might differ. In addition, a costing of the standard cover component would better assist customers to compare pricing from the outset.

In answering the questions above, we hope that we have provided some frontline insights from financial counsellors about the common issues relating to insurance coverage issues in Victoria.

We end our submission with the reminder again that simply changing standard definitions and cover will not address the ever-increasing service and equity gap in insurance. The current system is not working for all, and affordability and accessibility of insurance must be addressed in a holistic manner.

Thank you for the opportunity to provide this submission to Treasury's Consultation on behalf of Victorian financial counsellors who each year, assist over 23,000 vulnerable people experiencing financial hardship.