

# Standardising natural hazard definitions and reviewing standard cover for insurance

Submission to Treasury Consultation Paper

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# Contents

- Introduction and overview ..... 1**
- 1 Standardisation of definitions ..... 2**
  - 1.1 Support for standardisation ..... 2
  - 1.2 Definitions to be standardised ..... 4
- 2 Standard cover regime..... 6**
  - 2.1 Value of current standard cover regime..... 7
  - 2.2 Option 1 ..... 9
  - 2.3 Options 2 and 3 ..... 9



## Introduction and overview

AFCA<sup>1</sup> is the independent external dispute resolution (EDR) scheme for the financial services sector. We welcome the opportunity to contribute to this consultation, examining the standardisation of certain natural hazard terms, and reviewing the standard cover regime, to promote better outcomes for consumers in the event of natural disasters.<sup>2</sup> This submission draws on the experience of AFCA, and its predecessor schemes, which have handled financial service complaints including general insurance complaints for more than 30 years.

Insurance products are inherently complex. Consumers purchasing insurance products must balance uncertainty as to the scope of cover and how a policy may respond in a specific disaster event, with more concrete policy features, such as cost. While such trade-offs are inevitable features of insurance markets, the interaction between the defined scope of cover and the operation of policy definitions and exclusions is often poorly understood by consumers.

Qualitative consumer research conducted by ASIC for Report 768 *Navigating the storm: ASIC's review of home insurance claims* found that few consumers understood what their policy or claim covered.<sup>3</sup> The report stated:

*“In our consumer research, we observed that policy inclusions and exclusions were rarely known or completely understood, with some consumers assuming the ‘basics’ were covered such as flood, fire and accidental damage:*

- *Building claims were less predictable and more complex than contents claims – For example, consumers were upset to learn that building damage resulting from ‘wear and tear’ was not covered and were unaware of their obligations for keeping their property in ‘good condition’.*”

This finding is consistent with AFCA’s complaints handling experience, that most consumers did not read or understand the provisions that determined the scope of their policy coverage.

AFCA supports initiatives to simplify and clarify key features of insurance products. Simplification and clarification can also help insurers and their agent experts to process claims, manage complaints and communicate with their customers in a more efficient, fair, consistent and timely way.

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<sup>1</sup> The Appendix provides a brief overview of AFCA. For comprehensive information about AFCA, see our website [www.afca.org.au](http://www.afca.org.au).

<sup>2</sup> In recent years, AFCA has made other written submissions on issues in general insurance including standardisation of definitions and improvement of the standard cover regime. Examples are a [submission to Treasury in March 2019](#), a [submission to the ACCC in April 2019](#) and a [submission to the Royal Commission into National Natural Disaster Arrangements in April 2020](#).

<sup>3</sup> [Report REP 768 Navigating the storm: ASIC's review of home insurance claims, August 2023, p.10.](#)

This submission sets out AFCA’s observations about the:

- benefits for insurers and consumers that may flow from greater standardisation of natural hazard definitions
- operation of the standard cover regime noting the tension between insurers offering products with appropriate and meaningful levels of cover, and consumers’ need to access reasonably priced insurance products.

Unlike earlier reviews, this consultation is occurring in a context where insurers must comply with the design and distribution obligations (DDO). DDO are intended to help consumers obtain appropriate financial products and require a product issuer to make a target market determination (TMD) which, amongst other things, describes the class of retail clients for whom the product is likely to be appropriate, and specifies conditions on the product’s distribution and triggers for the review of the TMD.

While not falling directly within the scope of this consultation, we consider it important to consider the interaction between the proposals in the Consultation Paper and the DDO in ensuring consumers receive good outcomes from the insurance they purchase.

There is no single driver of under insurance, non-responsive insurance, or non-insurance with a number of factors influencing the availability, scope and cost of insurance products in Australia. Given the breadth and diversity of natural hazard risks in Australia—its geographical diversity and the uncertainty and potentially increased prevalence of certain risks in the context of climate change—it is uncertain whether a standard cover regime could be designed in such a way as to meet the twin objectives of establishing basic cover levels that meaningfully respond to those diverse risks that is also broadly accessible to consumers.

## 1 Standardisation of definitions

### 1.1 Support for standardisation

We support the proposals to standardise definitions of the key terms identified in the Consultation Paper.

AFCA considers that the standardisation of the definition of ‘flood’ has played a positive role helping to reduce uncertainty about the inclusion or exclusion of flood cover from a policy, both at policy inception and renewal. This also helps reduce the likelihood of complaints at IDR and to AFCA.

In AFCA’s submission to the *House of Representatives Standing Committee on Economics inquiry into insurers’ responses to 2022 major flood claims* (Flood Inquiry), we observed:

*“Despite the introduction of a standard definition for flood in general insurance policies in 2012, there remains considerable variation in the nature of flood coverage across and between insurers in Australia. Flood cover is not mandatory and where it is available, consumers may opt out of it. Some policies are also drafted so that storm and or rainwater can be excluded along with flood which significantly reduces the scope of cover. There are often also different treatments across policies for issues including temporary accommodation, treatment of mould, use of cash settlements and for important exclusions including maintenance and wear and tear [see p.20 at 4.1.1].”*

The experience suggests that improving consumer outcomes (particularly the responsiveness of policies to certain natural hazard events) demands attention both to definitions and to the operation of exclusions.

Complaints typically arise at the time of claim where ambiguity in a definition, or uncertainty about its operation alongside policy exclusions, can result in a lack of cover where a consumer may have assumed their insurance policy would respond.

Complaints relating to the operation of definitions, or the scope of cover will typically be recorded in AFCA’s data as complaints about the denial of claims (including due to exclusions or conditions) or claim amounts. 34% of the general insurance complaints AFCA received in FY 2023-24 (9,592 of 27,924 complaints) related to general insurance home building complaints.<sup>4</sup>

It is difficult to estimate the impact of inconsistent definitions on consumer outcomes, but a lack of common definitions makes it more difficult for consumers to exercise demand side pressure because of difficulties in comparing products.

We consider that standardisation can support more effective communication between insurers and customers at product purchase time, including supporting consumers to shop around where specific product features are important. However, as definitions operate alongside exclusions and other product features, it is necessary to temper expectations that standardisation can overcome broader product complexity for consumers.

We can see material benefits of standardisation on the supply side, in supporting insurers to make clearer and more timely claims decisions and to reduce consumer complaints where there is uncertainty about an insurer’s interpretation of a particular definition. It may also support insurers to ensure that experts are clearly instructed before they assess a claim to deliver consistent and quality expert reports, an issue AFCA highlighted in its submission to the Flood inquiry.

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<sup>4</sup> [General insurance complaints | Australian Financial Complaints Authority](#)

A further benefit of simpler, standardised definitions would be to help speed up the resolution of claims, noting the impact of delays which can amplify vulnerabilities in already traumatised communities.

In AFCA's experience, efforts to standardise definitions have the additional benefit of taking a systemic approach to known problems.

## 1.2 Definitions to be standardised

The Consultation Paper proposes standardising definitions of the terms 'fire', 'storm' and 'stormwater and rainwater run-off'. We support these proposals. Based on our complaint resolution experience, we believe standardisation of those definitions could provide important benefits, including:

- making it easier for consumers to compare policies
- simplifying disclosure and claims handling for insurers
- reducing the number of complaints made to insurers at IDR, which could also reduce the number of complaints referred to AFCA
- reducing the complexity of complaint resolution and decision making for AFCA.

We understand standardisation of definitions is a complex undertaking. Standardising three definitions as proposed in the Consultation Paper would be a good starting point. However, ongoing work to continue standardisation is needed. If some definitions are standardised and others are not, problems in understanding, comparability and under-insurance may continue.

AFCA suggests standardisation for all key terms relevant to damage caused by natural water hazards should be given priority. Following this, work on other key terms should be considered.

### 1.2.1 Exclusions

We agree with the analysis in the Consultation Paper that consumer confusion often arises in relation to **exclusions**. For example, fire insurance is commonly understood by consumers to cover the impact of ember attack and smoke damage generated by a fire even where those impacts are specifically excluded from the policy. For this reason, while standardising definitions may provide some improvement, it is not a 'silver bullet' capable of resolving the inherent complexity of home building insurance products.

In complaints that reach AFCA, the issue is often whether circumstances fall within an exclusion rather than whether they fall within a definition. For AFCA decision makers, the scope of exclusions remain key issues in complaints relating to claims for damage caused by water where, for example:

- storm damage to retaining walls or fences was excluded (as it is under the standard cover regime)
- internal damage from storm water was excluded where it did not come through an opening created by the storm
- damage due to run-off was excluded.

We expect complaints to continue to arise where policies exclude damage from both flood and run-off and the consumer does not realise this until they make a claim.

### 1.2.2 Distinguishing natural hazards

Although ‘flood’ now has a standard definition, natural hazards causing water damage continue to generate high numbers of complaints. To reduce complaints and improve claims handling, we suggest standard definitions focus on clearly distinguishing the concepts of flood, storm, stormwater run-off and rainwater run-off. We believe clearer definitions could help to reduce confusion and complaints.

Claims commonly hinge on whether damage was caused by stormwater run-off or floodwater (because damage due to one of those hazards was excluded). Claimants see that water has inundated their property and may not appreciate the distinction between run-off and flood. The application of exclusions can be complex – for example, where damage was due to a mixture of run-off and flood.

### 1.2.3 Expert reports

Insurers often rely on expert reports when deciding whether a definition in a policy was satisfied. AFCA’s submission to the Flood Inquiry explained that expert reports vary in quality and consistency and may be deficient in important respects.<sup>5</sup> The reports may, for example, not address important factors including statements or evidence provided by the claimant during the claims process, or they may draw conclusions not supported by adequate evidence.

If definitions were standardised as proposed, expert reports would still be required. However, the standardisation of definitions could make certain steps in the claims and complaints handling processes simpler. For example, it may be easier for insurers to instruct experts to comment on crucial issues and to use the reports obtained, lifting the consistency and performance of experts across the industry (and assisting insurers in the handling of claims and complaints). We expect it would also be easier for AFCA to assess, and where appropriate, rely on those reports in EDR.

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<sup>5</sup> Also see critical assessments of expert reports in [Making better claims decisions: A thematic inquiry, General Insurance Code Governance Committee, July 2023](#) and [The new benchmark for catastrophe preparedness in Australia, Deloitte, October 2023](#).

Case Study 1 is based on a complaint recently determined by AFCA – Complaint 912215.<sup>6</sup> The Determination highlighted deficiencies in expert reports obtained by the insurer.

## Case study 1

The complainant's home building insurance policy covered flood. The home was inundated in a major flood in 2022.

When the complainant lodged a claim, the insurer offered a cash settlement that did not include the cost of repairs to damaged stumps and piers, which formed the foundations of the house. The insurer argued this damage was not covered by the policy due to exclusions for pre-existing damage and the result of ground movement.

The insurer had obtained several expert reports, including:

- a builder's report suggesting the flood did not damage the foundations
- an engineer's report attributing the damage to a pre-existing foundation movement issue – not the flood
- an assessor's report concluding the damage was caused by the flood and no pre-existing issues contributed to it.

The complainant said the findings in the engineer's report were unreliable due to shortcomings in the investigations conducted, the evidence presented in the report and because it included illogical and contradictory statements.

AFCA considered all the circumstances of the complaint including all of the reports and other information. We found there were crucial gaps in the expert evidence on which the insurer relied.

AFCA decided the insurer had not established the damage to the piers and stumps was excluded and the cost of the damage should be covered in the cash settlement. Various quotes for repairs had been obtained but AFCA decided further investigation was needed to calculate a fair and reasonable settlement figure. AFCA required the insurer to obtain an actionable retail quote and pay that figure with a 20% uplift.

## 2 Standard cover regime

The standard cover regime in the *Insurance Contracts Act, 1984* (ICA) requires insurers to offer a certain level of cover unless:

- before the contract was entered into, the insurer 'clearly informed' the insured in writing; or
- the insured knew, or a reasonable person in the circumstances could be expected to have known, that the insurance contract provided less than the standard cover, or no cover.

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<sup>6</sup> AFCA Determinations are published on our website and can be searched through the '[Search published decisions](#)' facility.



The standard cover regime currently applies to six categories of insurance:

- motor vehicle insurance
- home buildings insurance
- home contents insurance
- sickness and accident insurance
- consumer credit insurance
- travel insurance.

The Consultation Paper indicates that the reform options would affect five of the categories listed above but is silent on home contents insurance.<sup>7</sup> It is uncertain if the policy intention—under Options 1, 2 and 3—is to repeal the standard cover regime for home contents insurance. Absent further detail, we note that:

- a single home insurance policy may include both building and contents cover
- consumers may be confused if the two types of cover differ
- the submission by the Insurance Council of Australia<sup>8</sup> referred to on page 19 of the Consultation Paper suggested consideration be given to developing a core package for **home and contents insurance**.

## 2.1 Value of current standard cover regime

Insurers hold significant repositories of data and modelling about the type, prevalence and intensity of disasters with deep claims experience about the operation of particular definitions and exclusions. This should see them well placed to ensure insurance products are fit for purpose and meet the diverse insurance needs of metro and regional Australia. This data and intelligence also informs compliance with the DDO, obligations which we consider provide an overarching framework for an assessment of the merits of the standard cover regime.

In AFCA's experience, insurers uniformly write policies that depart from standard cover. This means that, in practice, the benefit of the standard cover regime to consumers appears largely illusory, as consumers cannot generally go to market and purchase a retail general insurance product with standard cover.

### 2.1.1 Obligations imposed through standard cover regime

Although insurers depart from standard cover, the regime nevertheless imposes obligations on insurers providing the six categories of insurance within the regime. If

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<sup>7</sup> On page 17, the Consultation Paper contemplates changes to five categories of insurance within the standard cover regime at present and does not refer to home contents insurance. Options 2 and 3 are to create a new regime for home buildings insurance only.

<sup>8</sup> [Submission by Insurance Council of Australia](#) on 23 April 2019 to Northern Australia Insurance Inquiry by ACCC

these obligations are not met, consumers may make complaints at IDR or to AFCA or take action through the courts. This section focusses on the EDR perspective.

AFCA relies on the standard cover regime in resolving consumer complaints in certain circumstances, applying section 35 of the ICA. As set out above, if an insurer seeks to rely on a policy term that departs from standard cover, it must generally meet two requirements:

- the insurer must have provided a copy of the policy to the insured before the contract was entered into
- the relevant term must have been clear and unambiguous so that a person of average intelligence and education, having read the policy, would have readily understood they were not covered.

If the insurer does not meet these requirements, AFCA will give the insured the benefit of the standard cover in resolving a complaint.

Case Study 2 is based on AFCA's Determination of Complaint 993694. In that case, relating to a travel insurance claim, the insurer did not meet its obligations under section 35 of the ICA. Our Determination of Complaint 889891 provides a further recent example that relates to a home building insurance claim. Section 35 was referred to as an alternative basis for that decision.<sup>9</sup>

## Case study 2

The complainants, who were both over 80 years of age, purchased travel insurance. The insurance contract only provided medical cover for people aged over 80 if they obtained a separate upgrade.

The insurer's online application process provided warnings about the need for this upgrade through on-screen messages. The complainants did not apply for the upgrade however. Without cover for overseas medical expenses, their contract did not provide standard cover.

While travelling overseas, one complainant suffered injuries and needed extensive medical treatment. A claim to cover the costs was denied.

The insurance was subject to the standard cover regime. Section 35 of the ICA required the insurer to provide clear written disclosure of the departure from standard cover before entering into the contract.

AFCA considered the warnings provided by the insurer and found they did not meet the requirements of section 35. Our determination required the insurer to accept the claim, reimburse the complainants by a cash settlement for claim-related expenses, pay interest on the cash settlement sum and also pay compensation for non-financial loss.

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<sup>9</sup> AFCA Determinations are published on our website and can be searched through the '[Search published decisions](#)' facility.

### 2.1.2 Maintaining current consumer protections

AFCA considers the existing standard cover regime performs an important role by setting a benchmark for six categories of insurance cover, discouraging the development of new low value products. As well as setting this benchmark, the regime imposes specific disclosure requirements where an insurer departs from standard cover. In some complaints, if an insurer fails to meet those disclosure requirements, standard cover benchmarks are relied upon in AFCA decisions.

If the standard cover regime is repealed or altered, AFCA believes the reforms should be designed to ensure consumer protection is not reduced. This could involve introducing new provisions to maintain the current protections explained above.

## 2.2 Option 1

As set out above, while limited, the existing standard cover regime provides an important benchmark, requiring insurers to disclose to consumers where the cover on offer departs from standard cover and supporting AFCA decision making in some circumstances. We do not agree with the claim that repeal would have little to no impact on consumers or insurers. AFCA does not support repeal of the standard cover regime absent the introduction of an alternative, more effective measure.

## 2.3 Options 2 and 3

We consider that both Options 2 and 3 present risks of unintended consequences. We consider the key issues to be:

- the risk of eroding existing levels of cover currently available in the market
- complexity of a multi-tiered model that requires consumers to 'shop' a menu of levels of cover, policy terms, benefits and exclusions that may not ameliorate the risk that consumers end up with products that are not fit for purpose when a disaster occurs.

### 2.3.1 Baseline coverage

Options 2 and 3 both involve establishing baselines or lowest levels of coverage (that could be exceeded). It would be crucial to ensure a baseline is not set too low and does not cause standards to fall. Basic cover under a new regime should not be more limited than the general basic cover available in the market today. This may be more difficult under Option 3, which would require 'basic' cover to be lower than three other levels.

It is not clear how the four levels of coverage in Option 3 are intended to correspond with existing product ranges. Should 'bronze' correspond with what is now considered

standard – leaving ‘basic’ as the baseline? Changes of this kind could cause additional confusion undermining the broader policy objective.

We highlight that cover under the existing standard cover regime is in several respects better than the cover provided by many products on the market today.

### **2.3.2 Product comparison**

While Option 2 could enable consumers to easily compare base products, we understand it would not improve comparability for other products offered. Consumers considering those products would, as at present, have to compare different policies, terms, benefits and exclusions.

As Option 3 would be particularly complex, it may itself introduce confusion for consumers, as the Consultation Paper acknowledges. However, it may facilitate comparisons of different ranges of cover.

Our experience indicates that consumers normally compare broadly similar products on price, without fully considering the scope of cover, which varies subject to differing definitions and exclusions. With the multi-tiered structure in Option 3, price-based comparisons may be more effective but may not respond to the policy issues of under or non-insurance.

### **2.3.3 Damage caused by natural water**

The Consultation Paper suggests on page 17 that the base product under Option 2 could include an opt out arrangement for flood coverage or for all natural water related damage.

We would be concerned that such an approach may erode existing cover for consumers. For example, in complaints arising from the major floods in 2022, AFCA required several claims to be paid in circumstances where the insurer was relying on an exclusion for floodwater inundation to deny a claim but could not prove that the loss was in fact caused by floodwater inundation, and other policy terms did respond. Our concern is that an opt-out arrangement in which all water related damage was excluded will result in an overall reduction in cover available for all consumers.

The Consultation Paper does not clarify whether the opt out arrangement (for either flood or all natural water related damage) would apply under Option 3. Our comments above apply to the arrangement whether it is suggested under Option 2 or 3.

### **2.3.4 Additional considerations**

The discussion of Options 2 and 3 in the Consultation Paper does not address all of the factors that may require attention in reviewing the standard cover regime. To provide examples, we refer briefly to two issues relating to definitions of terms used in standard cover provisions.

Definition of contents:

- Standard cover for home contents insurance is limited by the definition of 'contents' in section 4 of the Insurance Contracts Regulations 2017. Paragraph (d) of that definition excludes various items (such as works of art, jewellery and gold or silver articles) if their value exceeded \$500 when the insurance contract was entered into. AFCA believes the \$500 limit is out of date and should be reviewed if the definition will continue to apply in future.

Definition of home building:

- Section 4 of the regulations defines 'home building' to exclude (among other things) 'a building that is let or rented by the insurer, as lessor, as a business, and is not the principal residence of the insured'. This would arguably include investment properties. If any reforms proceed, we believe this exclusion should be clarified.

AFCA would be happy to provide any further input that may be helpful in the development of reforms.

## Appendix – About AFCA

AFCA is the independent EDR scheme for the financial sector. It replaced the Financial Ombudsman Service, the Credit and Investments Ombudsman and the Superannuation Complaints Tribunal.

AFCA provides fair, independent and effective solutions for financial complaints. It does this not only by providing complaint resolution services free to consumers, but also by working with its members to improve their processes and drive up industry standards of service, thereby minimising complaints.

More broadly, AFCA plays a key role in restoring trust in the financial services sector. In addition to providing solutions for financial complaints, AFCA has responsibilities<sup>14</sup> to identify, resolve and report on systemic issues and to notify ASIC, and other regulators, of serious contraventions of the law. A separately operated and funded team within AFCA provides services to support independent committees that monitor compliance with several financial services industry codes.

AFCA's service is offered as an alternative to tribunals and courts to resolve complaints about financial firms made by individual and small business consumers. We consider complaints about:

- credit, finance and loans
- insurance
- banking deposits and payments
- investments and financial advice
- superannuation.

AFCA's role is to assist consumers to reach agreements with financial firms about how to resolve their complaints. We are impartial and independent.

If a complaint does not resolve between the parties, we will decide an appropriate outcome, including awarding compensation for losses suffered or substituting the trustee's decision in the case of a superannuation complaint.