



Standardising natural hazard definitions and reviewing standard cover for insurance

Consultation paper

March 2024

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In the spirit of reconciliation, the Treasury acknowledges the Traditional Custodians of country throughout Australia and their connections to land, sea and community. We pay our respect to their Elders past and present and extend that respect to all Aboriginal and Torres Strait Islander peoples.

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Consultation Process

Request for feedback and comments

Interested stakeholders are invited to comment on the issues raised in this paper by 4 April 2024.

Submissions may be lodged electronically or by post, however electronic lodgement is preferred via email to standarddefinitions@treasury.gov.au. For accessibility reasons, please submit responses via email in a Word, RTF or PDF format.

Submissions will be shared with other Commonwealth agencies where necessary for the purposes of this review. All information (including name and address details) contained in submissions may be made publicly available on the Australian Treasury website unless you indicate that you would like all or part of your submission to remain in confidence. Automatically generated confidentiality statements in emails are not sufficient for this purpose.

If you would like only part of your submission to remain confidential, please provide this information clearly marked as such in a separate attachment. Legal requirements, such as those imposed by the *Freedom of Information Act 1982*, may affect the confidentiality of your submission.

Closing date for submissions: 04 April 2024

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The principles outlined in this paper have not received Government approval and are not yet law. As a consequence, this paper is merely a guide as to how the principles might operate.

Introduction

In the 2022–23 October Budget, the Australian Government announced its intention to improve consumer understanding of insurance products as part of a package of reforms designed to reduce the cost of insurance in communities at risk of natural disasters, enhance mitigation measures and promote better outcomes for consumers.¹ Treasury has been tasked with exploring possible natural hazards terms to standardise for insurance contracts and to review the standard cover regime.

Standard definitions in insurance refers to the process of mandating that all insurers use the same definition for a particular event in their insurance contracts. Currently the only natural hazard definition that is standardised is 'flood.'

The standard cover regime in the *Insurance Contracts Act 1984* requires insurers to offer a baseline 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.

Context

Insurance costs are rising

Consumer insurance costs have risen sharply over recent years and are expected to continue to rise due to global factors, increased natural hazard events, and asset price inflation. This is not unique to Australia and is a consistent trend with many countries globally.

The Actuaries Institute reported a median increase in home insurance costs of 28 per cent for the year to March 2023.² Higher risk properties experienced a 50 per cent increase in premiums. The same report estimated that 12 per cent of Australian households were experiencing insurance affordability stress, where insurance costs were greater than four weeks of household gross income. The drivers of rising household insurance costs include:

- Increases in the cost of rebuilding – a combination of supply shortages, disaster-related surges in demand, and general asset price inflation.
- Increased incidence of natural hazards.
- Increases in reinsurance premiums paid by retail insurers.

The households most exposed to rising insurance costs are often those with greater social or economic disadvantage. In 2022, the Actuaries Institute reported that households with insurance affordability stress are more likely to be renting, older, single person household, have low savings, and live in socio-economically disadvantaged areas.³ These households are concentrated in parts of Australia exposed to severe weather and natural perils: North Queensland, Northern Territory and Northern New South Wales.

¹ Media release 26 October 2022, <https://ministers.treasury.gov.au/ministers/stephen-jones-2022/media-releases/landmark-funding-help-reduce-insurance-costs>

² Actuaries Institute, August 2023, Home Insurance Affordability Update. [Actuaries Institute website.](#)

³ Actuaries Institute, August 2022, Home insurance affordability and socioeconomic equity in a changing climate: Green paper. [Actuaries Institute website.](#)

Misunderstanding of cover can lead to unintentional underinsurance

When consumers misunderstand the insurance cover they buy, they may become unintentionally underinsured, which means that are not covered for events that they expect to be covered for when purchasing the product.⁴

The Australian Competition and Consumer Commission's (ACCC) 2020 Northern Australia Insurance Inquiry Report found that inconsistencies in how insurers define certain terms were limiting consumers' ability to make effective comparisons between policies.⁵ The Actuaries Institute reports that, with the many facets of home insurance, price comparison in the current market can lead to 'false affordability' where important coverage features are unintentionally traded off to, leading to underinsurance.⁶ In 2023, CHOICE reported complex product design and lack of comparability as a reason for underinsurance.⁷

These sentiments were echoed in February 2024 during public hearings for the House of Representatives Standing Committee on Economics inquiry into insurers' responses to the 2022 floods. Statements from consumer advocacy groups and regulators emphasised the challenges posed by the current standard cover and definitions regime, and the pressing need to undertake reforms.

Large insurance catastrophes are exacerbating pressures

In 2022-23, complaints to Australian Financial Complaints Authority (AFCA) regarding general insurance rose 50 per cent to 27,924, or 28 per cent of complaints⁸, with the leading cause of complaint the delay in insurance claim handling. Much of the delay in claims handling reflect surges in claim numbers associated with major catastrophes.

Insurers are under pressure to respond and resolve claims during catastrophic events, where large groups of people are simultaneously affected. For example, the Deloitte review of insurer claims processes in the 2022 East Coast Floods, which saw six times more claims than the average catastrophe since 2016, found gaps in policy design and communication processes which led to longer processing and closure times.⁹

Yet, even as delays occur, consumer confusion and frustration often arise when consumers misunderstand their cover, their expectations are not met, and communication is not transparent.¹⁰

Legislation is intended to protect consumer interests and promote fairness

Following the 1978 Australian Law Reform Commission review of insurance, the Federal Parliament legislated the *Insurance Contracts Act 1984* to protect the interests of insurance contract parties and ensure that contracts and practices were fair. Two key components of the *Insurance Contracts Act 1984* are the standard cover regime and the duty of utmost good faith.

A fair and well-functioning insurance sector requires consumers to be well informed. The standard cover regime was intended to address the problem consumers face in understanding the extent of

⁴ CHOICE, 2023, Weathering the storm: Insurance in a changing climate. [Choice website](#).

⁵ ACCC, 2020, Northern Australia Insurance Inquiry Final Report. [ACCC website](#).

⁶ Actuaries Institute, 2020, Property Insurance Affordability: Challenges and Potential Solutions. [Actuaries Institute website](#).

⁷ CHOICE, 2023, Weathering the storm: Insurance in a changing climate. [Choice website](#).

⁸ AFCA, 2023, Annual Review. [AFCA website](#).

⁹ Deloitte, 2023, A New Benchmark for Catastrophe Preparedness in Australia. [ICA website](#).

¹⁰ ASIC, 2023, Navigating the storm: ASIC's review of home insurance claims. Report 768. [ASIC website](#).

coverage provided by an insurance policy. This support is important to help consumers' make efficient and appropriate choices with respect to insurance. Conversely, a lack of transparency or effective disclosure practices makes it harder for consumers to make informed decisions about products to meet their needs. In addition to information being disclosed to consumers, it should also be presented in a way that enables the consumer to make informed and appropriate decisions about the insurance cover they purchase. The risks of ineffective and inadequate disclosure include inadvertent underinsurance, lack of understanding of the insurance product purchased and purchase of insurance cover which does not serve the consumer's purpose.

The *Insurance Contracts Act 1984* also introduced a duty of utmost good faith as an implied term in insurance contracts. Breach of the duty is considered a breach of contract, as well as a breach of the legislation. While there is no definition of the duty in the legislation, the High Court of Australia has described the duty of the insurance company towards the insured as the requirement to 'act, consistently with commercial standards of decency and fairness, with due regard to the interests of the insured.'

In 2012, following significant flooding across Australia, the Commonwealth introduced a standard definition of flood. In the 2010-11 floods there were instances of neighbours being affected by the same flood and both having flood cover but receiving different claims outcomes from their insurers due to different definitions of flood in their respective insurance contracts. Standardising the definition of flood was intended to avoid such a situation occurring again, with the Minister for Financial Services & Superannuation at the time, the Hon Bill Shorten MP, noting 'a flood is a flood. Never again do Australians want to see a situation, as we saw during the Queensland floods of 2011, where neighbours hit by the same flood get different levels of cover because of technical definitions in an insurance contract.'¹¹

Further reform may support insurance markets and increase resilience


The insurance protection gap describes circumstances where there is insufficient insurance protection to recover well from loss events. The ACCC's 2020 Northern Australia Insurance Inquiry Final Report estimated the rate of home non-insurance in Australia to be 11 per cent.

As insurance costs for Australian consumers increase, the rate of underinsurance will likely continue to grow as more consumers will be unable to afford insurance. Further, without increasing consumer understanding of insurance contracts, many consumers may continue to be unintentionally underinsured and not covered for events they expect to be covered for. Increased rates of underinsurance reduce the resilience of Australian consumers to withstand natural disasters and other shocks.

Insurance is an important feature of economic and financial resilience for Australian consumers to natural disasters and other shocks. Through insurance cover, consumers have access to the resources they need for recovery and rebuilding after a natural disaster. Without appropriate insurance coverage, consumers will not have access to the resources they need to recover and rebuild.

The Australian Government is already pursuing actions to reduce risks and increase resilience of Australian households to natural disasters. These include initiatives such as investment in the Disaster Ready Fund, the Hazards Insurance Partnership, and the Australian Climate Service's insurance data asset.

¹¹ The Hon Bill Shorten MP, 18 June 2012, Media Release. [Treasury website](#).



Targeted intervention may support consumer understanding of coverage and thereby reduce unintentional underinsurance and increase resilience. Two areas for potential targeted intervention are described in the subsequent sections:

- 1) Standardising common terms.
- 2) Reviewing standard cover.

Standardising common terms and reviewing standard cover may reduce the number of insurance related complaints made to AFCA. As detailed above, general insurance complaints to AFCA rose 50 per cent in 2022-23. Increased consumer understanding of insurance coverage could reduce the number of such disputes.

Consultation questions

1. To what extent is consumer misunderstanding of insurance policies leading to unintentional underinsurance or inappropriate insurance?
2. What are the consequences of not addressing these issues?
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?

Standardising common terms

The role of standard definitions

Previous reports and inquiries have acknowledged benefits in standardising additional natural hazard terms, and some also identified specific terms that could benefit from standardisation. The ACCC Northern Australia Insurance Inquiry recommended more natural hazard terms be standardised for insurance purposes, such as ‘action of the sea’ and ‘storm’. Likewise, the Royal Commission into National Natural Disaster Arrangements reported that standard definitions provide “consistent scope in relation to a given insurable event” but noted that only flood had been standardised. The Commission received evidence “suggesting benefits in standardising the definition of ‘fire’ and other natural hazards”.

The 2017 Senate Economics References Committee report also recommended the Government, in consultation with industry and consumer groups, develop additional standardised definitions of key terms for general insurance purposes.

Standardising definitions for insurance purposes is a complicated process, requiring insurers to make numerous system changes to implement. There are a range of factors that need to be considered when developing standard definitions, such as the effect standard definitions might have on the pricing of insurance products and any implications for product differentiation. Ultimately, the costs borne by insurers in standardising definitions may be passed through to consumers through higher premiums, or result in lower returns for shareholders.

The 2011 Natural Disaster Insurance Review, which recommended a standardised definition of flood, noted that the key to standardisation is to make the term narrow enough to be meaningful to consumers and to not remove any cover the policy already has if it is excluded. However, stakeholders acknowledged that standard definitions should not be so narrow as to exclude damages that a consumer could reasonably expect to be included.

The Government is currently only considering standardising natural hazard definitions. Stakeholders have identified several non-hazard terms that frequently cause confusion among consumers, such as ‘wear and tear’ and ‘malicious acts.’ However, standardising such terms is beyond the scope of this project.

Priority terms for standardisation

The intent of this paper is to seek feedback on the natural hazard terms that should be standardised, not to try to establish the definitions themselves, which would require a standalone consultation process after a decision regarding which terms to standardise.

The benefits of standardisation must be assessed for each term to prioritise which terms to standardise. To guide selection, three prompting questions are being considered:

- Has the term been identified as causing consumer confusion, for instance, in previous reviews or by stakeholders?
- Does the term relate to a significant area of coverage in the Australian general insurance market?
- Has this particular natural hazard generated significant insured damages in Australia in recent years or is it expected to do so in the future?

With the information available, three natural hazard terms are proposed for standardisation: fire, storm, and stormwater or rainwater runoff. These priority terms are described below.

Fire

Several independent reviews have identified fire as a natural hazard term that would likely benefit from standardisation. The Royal Commission into National Natural Disaster Arrangements found that standard definitions “provide consistent scope in relation to a given insurable event” and noted that the Commission “received evidence suggesting benefits in standardising the definition of 'fire' and other natural hazards”.¹²

In a 2022 research paper, the Financial Rights Legal Centre (FRLC) recommended additional natural hazards terms should be standardised following ‘flood’ and identified ‘fire’ as one of the terms likely to benefit.¹³ In particular, the FRLC noted that, while consumers generally understand key concepts of what natural hazard terms entail (for example, they know what a fire is) and the types of damages typically associated with these events (for fire, this may include damage from direct burning, smoke and melting), they often do not fully understand the exclusions and qualifications that might apply to the damages covered by insurance policies. For example, customers would generally expect a home insurance policy for fire to cover all forms of loss associated with fire. In reality, many policies will, for example, only include losses due to direct burning and not include any damage related to heat, smoke or melting.

Several stakeholders identified fire as a source of consumer confusion in their discussions with Treasury. In particular, they recognised that different exclusions and definitions of fire resulted in consumers having insufficient understanding of their coverage at claims time. In contrast, a major insurer voiced concerns that a standard definition of fire was likely to be ineffective at resolving consumer confusion, and a broad definition of fire that covers a wide range of damages would likely result in premium increases for consumers. However, the consensus from stakeholders was that fire would likely benefit from standardisation.

The Actuaries Institute estimated that the bushfire component of home insurance contributes \$33 (or 2 per cent) to the average home insurance premium nationwide.¹⁴ This figure is skewed downwards by the significant portion of the population who are not exposed to bushfire risk. Bushfire risk makes up around 4 per cent of total home insurance premiums nationwide, representing \$332 million of the \$7.4 billion in written premiums for home insurance in Australia.

The Actuaries Institute observes that bushfire risk in Australia is primarily concentrated in the east coast of NSW, central regional Victoria, Tasmania, and the south of Western Australia. These regions have experienced catastrophic bushfire events over the past 15 years, most notably the 2009 Black Saturday fires and the 2020 Black Summer fires. Several bushfires have been designated Insurance Catastrophes by the ICA in recent years and have resulted in significant insured losses (see Table 1).

¹² Royal Commission into National Natural Disaster Arrangements, 2020, Final Report. Page 421. Available [Royal Commission website](#).

¹³ FRLC, 2022, Standardising General Insurance Definitions. Available [FRLC website](#).

¹⁴ Actuaries Institute, August 2022, Home insurance affordability and socioeconomic equity in a changing climate: Green paper. [Actuaries Institute website](#).

Table 1: Costliest bushfire events since 2009¹⁵

Year	Bushfire	Insured damages (Original loss value)
2019/20	Black Summer (NSW, QLD, SA, VIC)	\$2.32 billion
2009	Black Saturday (VIC)	\$1.07 billion
2013	Blue Mountains (NSW)	\$217 million
2015	Pinery (SA)	\$172 million
2015	Great Ocean Road (VIC)	\$109 million

Treasury considers that fire sufficiently meets the criteria above and could therefore benefit from standardisation. It is understandable that there would be consumer confusion regarding what is and is not covered, with insurers having different approaches to dealing with melting caused by extreme heat, and damage caused by ash and smoke. While the focus of the community is currently on flood, issues around the definition of fire are likely to rise in prominence when significant bushfires occur.

Storm

Independent reviews have frequently suggested storm as a term that could potentially benefit from standardisation. The ACCC Northern Australia Insurance Inquiry recommended that Treasury develop a proposal to standardise definitions of prescribed events such as storm, noting it is a frequent source of confusion for consumers. Storm is a particularly complex concept, as it includes a range of activities that can cause damage, such as rain, wind, hail, snow, and flash flooding. There are also different types of storm events, such as cyclones and tornadoes.

FRLC analysis of PDSs found that there were differences in what insurers included in storm damage, and recommended storm for potential standardisation. FRLC found that, despite flood being standardised in 2012, there remained uncertainty over whether water damage resulting from natural events is covered. Examples of this uncertainty include whether flood damage includes storm damage, which aspects of water damage are included, and whether storm damage is separate from storm surge and/or wind.

In discussions, several stakeholders noted that a standard 'storm' definition would likely be beneficial as variations between storm and storm surge have been problematic for consumers. A major insurer also suggested that storm and storm surge are often confused with actions of the sea. Many stakeholders also noted confusion regarding the difference between storm, storm surge, and stormwater/rainwater run-off, and whether any one of these terms is covered by a policy that explicitly mentions one of the others.

In 2022, the Actuaries Institute estimated that the storm component of home insurance contributes \$230 (approximately 15 per cent) to the average home insurance premium nationwide.¹⁶ This proportion is as high as \$306 in both NSW (17.1 per cent) and Queensland (14.7 per cent). In terms of

¹⁵ Data published on [ICA Data Hub](#)

¹⁶ Actuaries Institute, August 2022, Home insurance affordability and socioeconomic equity in a changing climate: Green paper. [Actuaries Institute website](#).

the total value of home insurance premiums across the country, storm is the natural hazard with the biggest contribution, representing \$2.3 billion (or 31 per cent) of the \$7.4 billion written for home insurance in Australia.

Storm costs in Australia are prevalent along the east coast, and storm risks are typically higher in metropolitan areas along the east coast. Since 2010, Australia has seen several significant and severe storm events that have generated significant claims (see Table 2).

Table 2: Costliest storm events since 2010¹⁷

Year	Bushfire	Insured damages (Original loss value)
2010	Perth (WA)	\$1.05 billion
2010	Melbourne (VIC)	\$1.04 billion
2015	East Coast Low (NSW)	\$949.6 million
2021	SA & VIC	\$891.7 million
2011	Melbourne (VIC)	\$485.6 million

Treasury considers that storm sufficiently meets the criteria outlined above and could therefore benefit from standardisation. A definition of storm would need to be clear that storm cover, flood cover and rainwater runoff are separate.

Stormwater and rainwater run-off


Stormwater and rainwater run-off are often used interchangeably to refer to rainwater that runs off land and flows away from the area where it originally falls. The South Australian Environmental Protection Agency describes urban stormwater as rain that runs off surfaces where water cannot penetrate such as roofs, driveways, and roads.¹⁸ This water is usually carried away by a stormwater drainage network to natural bodies of water such as creeks, rivers, and the sea. Urban areas tend to have more impenetrable surfaces that generate more run-off and lead to higher stormwater volumes and discharges.

Independent reviews have noted that stormwater and rainwater run-off are frequent sources of consumer confusion, particularly regarding their interaction with the standard definition of flood. For example, FRLC’s research into standard definitions identified cases where insurers automatically exclude stormwater and rainwater run-off from policies once a consumer opts out of flood cover, while in other circumstances consumers can opt out of flood cover whilst still being covered by stormwater run-off.¹⁹ From a consumer perspective, their house has been inundated by water and it may not be clear why in some instances they are covered by their insurance and in other instances they are not.

¹⁷ Data published on [ICA Data Hub](#)

¹⁸ SA EPA, 2023, Understanding Stormwater. [SA EPA website](#).

¹⁹ FRLC, 2022, Standardising General Insurance Definitions. Available [FRLC website](#).



The insurer responses to the 2022 East Coast Floods showed challenges with consumer understanding of stormwater. The Deloitte review of insurer responses found policyholders were confused by the definitions and descriptions of flood and stormwater in their policies and how the two were described by insurers and their representatives. Without a knowledge of hydrology, necessitating expert assessment, the claim decision could not be made or not made in a way that accorded with consumer understanding of the cause.²⁰

Treasury considers that stormwater/rainwater run-off sufficiently meet the criteria outlined above and could therefore benefit from standardisation. It could also be beneficial to specify a time frame for stormwater/rainwater run-off damages following a storm or heavy rain (such as 24 or 48 hours), which is often a feature of cover for run-off.²¹ The standard definition should make it clear that stormwater/rainwater run-off is a separate to flood and storm cover or alternatively, that they should be bundled together.

Importantly, while a standardised definition of stormwater and rainwater run-off may reduce uncertainty, it will not resolve all complexity in the event of water damage to properties. Unless stormwater and rainwater run-off are bundled together with flood cover (in which case properties with such cover would be insured against any inundation by water), it will remain necessary to undertake hydrologist reports to determine the source of the water damage.²²

Standardisation being progressed by industry

In July 2023, the General Insurance Code Governance Committee (CGC) found that, of a sample of 42,956 denied home insurance claims, 55 per cent relied on ‘wear and tear’ or ‘maintenance’ exclusions, or both. Following complaints from over 10,000 policyholders, half of these denials were overturned. Similarly, a 2022 ASIC review found that consumers did not understand ‘wear and tear’ exclusions or their property maintenance obligations, while AFCA observed that consumer organisations consistently highlight dissatisfaction and disputes arising from claim denials based on ‘wear and tear’ exclusions.

Following these reviews, the ICA announced work to develop a standard definition of ‘wear and tear’. This work is being conducted independently of Treasury’s work on standard cover and definitions.

Terms not considered a priority for standardisation at this time

There are a range of natural perils that are commonly covered by consumer insurance contracts but represent a lower share of losses or consumer confusion about coverage. Through consultation and research to date, these terms have not been identified as causing consumer confusion, do not relate to a significant area of coverage, or have not been a driver of significant insured damage in recent years.

²⁰ Deloitte, 2023, The new benchmark for catastrophe preparedness in Australia: A review of the insurance industry’s response to the 2022 floods in South-east Queensland and New South Wales (CAT221)

²¹ FRLC, 2022, Standardising General Insurance Definitions. Available [FRLC website](#).

²² Given the differing risk profile associated with the different types of water damage, bundled coverage would cost more than either flood or stormwater and rainwater run-off alone. It is therefore possible that, due to the price point of bundled coverage, a consumer may forego protection that they otherwise would have obtained were the offerings separate.

Storm surge

Previous independent reviews such as the ACCC Northern Australia Insurance Inquiry recognised storm surge is a source of consumer confusion. Additionally, as demonstrated above, storm-related insurance policies are significant contributors to insurance premiums, and storms have generated a significant volume of insurance claims in recent years. However, several stakeholders mentioned that, while considerable variation exists between existing definitions of storm surge across insurers, this is not yet causing significant harm or disadvantage to consumers. If storm and stormwater/rainwater run-off are standardised as proposed above, this would likely clear up a sufficient amount of confusion that currently exists regarding the interaction of natural water-related terms.

Earthquake

In 2022 the Actuaries Institute estimated that earthquake is a larger contributor to home insurance premiums than bushfire, representing \$35 (or 2.5 per cent) of the average home insurance premium of \$1,534, compared to \$33 (or 2 per cent) for bushfire.²³ While earthquakes are less frequent than other hazards such as bushfires and storms, they can generate significant insurance claims. Most recently, the 2021 Mansfield earthquake in Victoria generated over \$100 million in claims.²⁴ However, there has not been sufficient evidence presented in either independent reviews or Treasury's targeted consultation process that suggests earthquake is a common source of consumer confusion. As such, it is not proposed to standardise the definition of earthquake.

Actions of the sea

Previous independent reviews, such as the ACCC Northern Australia Inquiry and the 2017 Senate Economics Committee Inquiry identified actions of the sea as a term that could benefit from being standardised. Submissions to the latter inquiry provided an example of one insurer excluding damages stemming from actions of the sea but covered losses related to tsunamis, which it did not consider an action of the sea. This contrasted with at least one other insurer who did consider tsunamis to be actions of the sea. However, following stakeholder engagement, Treasury does not consider actions of the sea a priority hazard term for standardisation. Some consumer groups noted that actions of the sea did not arise in their advocacy/consumer complaint processes as much as other terms, such as bushfire and storm.

Consultation questions

4. Do you agree with the priority terms that are proposed for standardisation (fire, storm, stormwater, and rainwater run-off)?
5. For those terms that are proposed to be standardised, are there any exclusions that you believe should apply?
6. Are there any additional natural hazard terms you think should be standardised?

²³ Actuaries Institute, August 2022, Home insurance affordability and socioeconomic equity in a changing climate: Green paper. [Actuaries Institute website](#).

²⁴ Data published on [ICA Data Hub](#)

Reviewing standard cover

The existing standard cover regime

The standard cover regime was established to standardise terms and conditions between prescribed types of insurance contracts. By restricting the scope for variation between comparable insurance contracts and ensuring a minimum level of consistency, the standard cover regime sought to guard against a lack of coverage for events that are commonly expected to be covered by that type of insurance contract. By reducing the degree to which insurance policies could depart from a 'common' understanding of what any given insurance contract should cover, this aimed to reduce the likelihood of inadvertent underinsurance by consumers.

Standard cover requirements for a range of types of general insurance contracts are set out in the Insurance Contracts Act. However, a contract can deviate from standard cover provided that:

- 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.

Currently, insurers meet the requirement to 'clearly inform' the consumer through the provision of a PDS that discloses the cover that is being provided. However, both stakeholder feedback and previous independent research suggests that PDSs are generally long and complicated and frequently not read or not understood by consumers²⁵, making any disclosure ineffective at alerting customers to the fact their policy does not align with the standard cover regime.

In 2017, the ICA reported that only around 20 per cent of consumers engaged with a PDS in their pre-purchase decision making, and while consumers often believe they understand the terms of their insurance policy, the ICA found that actual comprehension levels were low in comparison to confidence levels.²⁶ In particular, there is significant consumer misunderstanding about the type of home insurance policies purchased.

A 2018 Monash University study of how consumers engage with mandated disclosure information for home contents insurance – such as PDSs and key fact sheets – found no consistent effect of disclosure on the quality of consumers' choices.²⁷ A significant number of participants made a suboptimal decision, with up to 42 per cent choosing the 'worst' product on offer, even when having access to the PDS and key fact sheet. This study challenged the often-unspoken assumption that consumers will become better informed if insurers improve their disclosure arrangements.

The proportion of homeowners engaging with PDS has consistently stayed low. CHOICE research in 2023 estimated that less than half (46 per cent) of homeowners had read their Product Disclosure Statement.²⁸

The requirement for the consumer to be expected to have known that their contract provides less than standard cover can also be met by the insurer advising the customer that they are not covered for a particular event that would form part of standard cover when the customer asks. This is not

²⁵ ACCC, 2020, Northern Australia Insurance Inquiry Final Report, page 462.

²⁶ ICA, 2017, Consumer Research on General Insurance Product Disclosures: Research findings report, February 2017, page 18.

²⁷ Malbon, J, & Oppewal, H., 2018, (In)effective disclosure: an experimental study of consumers purchasing home contents insurance, Monash Business School and Monash Faculty of Law. Available [Financial Rights Legal Centre website](#).

²⁸ CHOICE, 2023, Weathering the storm: Insurance in a changing climate. [Choice website](#).

heavily relied upon in practice as it can be difficult to prove that the customer knew that their contract provided less than standard cover.

Consumer and industry groups have overall indicated that the current regime is not fit for its purpose. Standard cover can be altered to become non-standard such that it may exclude 'standard' events, which makes consumers unclear on the extent of the coverage of their insurance policy. Common deviations from the standard cover regime include insurers limiting their liability to a nominated sum insured (rather than the total replacement cover provided for in the regime), as well as the exclusion of events such as actions of the sea and erosion. Given the ease with which insurers can offer non-standard cover policies, the standard cover regime is having only a very limited, if any, impact in practice.

Reviewing the standard cover regime aligns with recommendations from the 2017 Senate Economics Committee Inquiry, ACCC Northern Australia Inquiry, and the Royal Commission into National Natural Disaster Arrangements. Submissions to these independent reviews from stakeholders further acknowledged the inadequacies of the current standard cover regime. For example, in its submission to the ACCC inquiry,²⁹ the ICA agreed with the general assessment that the regime did "not facilitate good insurance decisions", nor did it "make comparison between policies easier". The ICA also noted that it can be difficult for consumers to appreciate deviations from standard cover, as the standard cover regime assumes consumers are aware of the standard cover provisions as set out in the Regulations and can readily appreciate the ramifications of their coverage. In the submission, the ICA considered it would be productive to develop a core package of cover for home and contents insurance which would be common to all policies, on top of which insurers could include additional coverage if it wanted. The ineffectiveness of the standard cover regime, and the likely benefits of strengthening the regime, is supported in other submissions to the ACCC inquiry, such as those from Australian Securities and Investment Commission³⁰, Consumer Action Law Centre³¹ and Financial Rights Legal Centre.³²

Feedback from stakeholders during targeted consultation suggests that:

- consumers rarely (if ever) engage with their PDS before claims time, meaning there is an epidemic of consumers not understanding what they are covered for when first purchasing the cover.
- the standard cover regime is effectively redundant in its current form; and
- it is worth exploring options to strengthen the standard cover regime to reduce problems caused by consumer misunderstanding.

Insurance industry members, when discussing options for strengthening the standard cover regime, reiterated their preference for a mandated standard cover that allows insurers to "innovate above" a baseline level of coverage.

²⁹ ICA submission, 2019, ACCC Northern Australia Insurance Inquiry. Available [ACCC website](#).

³⁰ ASIC submission, 2019, ACCC Northern Australia Insurance Inquiry. Available [ACCC website](#).

³¹ CALC submission, 2019, ACCC Northern Australia Insurance Inquiry. Available [ACCC website](#).

³² FRLC submission, 2019, ACCC Northern Australia Insurance Inquiry. Available [ACCC website](#).

Options to amend the standard cover regime

Option 1: Repeal the standard cover regime in its entirety

The dominant view is that the current standard cover regime is unfit for purpose. One option for reform is to repeal the regime in its entirety. Doing so would have little to no impact on consumers or insurers. Insurers will likely face minor compliance costs by removing references to the standard cover regime from their PDSs, but this could be offset with a reduced amount of ‘red tape’ with which insurers must comply.

Pursuing this option could be viewed as a ‘missed opportunity’ to amend the standard cover regime in a way that provides material benefits to consumers.

Option 2: Amend the standard cover regime to mandate insurers offer a baseline level of coverage for home building insurance only

This option would mandate insurers offer a certain baseline level of coverage for policies they choose to issue. The baseline level of insurance would need to reflect the cover a consumer would expect to receive when purchasing insurance and would enable insurers to offer coverage and services that go beyond the minimum standard.


Stakeholders have previously identified the potential benefits of reforming the standard cover regime so that it acts as a baseline level of coverage. As mentioned above, in its submission to the ACCC Northern Australia Insurance Inquiry, the ICA recognised that developing a “core package” of cover for home and contents insurance that were common to all policies would likely be a productive reform. The ICA suggested that it should be up to individual insurers to decide if they wanted to offer only those protections laid out in the updated standard cover regime or include additional features.

In submissions to the 2017 Senate Economics References Committee, several consumer groups also supported the approach of using the standard cover regime to introduce a mandated level of baseline cover in insurance policies. CALC recommended the Committee consider the possibility of making standard cover a form of “default” cover, suggesting consumers could opt for “lesser or higher” cover, but standard cover would act as a “safety net”.³³ Similarly, the FRLC recommended the Government explore introducing a “standard minimum cover” to address the ineffectiveness of the current standard cover regime.

In Treasury’s targeted consultation process, insurance industry members, consumer groups and regulators all noted the benefit of – and in some cases, strongly recommended the introduction of – a mandated baseline level of standard cover. Some stakeholders noted that, while a mandated standard cover would not necessarily result in increased consumer understanding of their policies (that is, it would still be up to the consumer to read the PDS and understand the parameters of their coverage), it would enhance product comparability. Instead of comparing both the terms and pricing of different products across a range of offers, a mandated baseline level of insurance would mean consumers could compare policies primarily on price as the basic features would be the same across all policies. The incorporation of standard definitions for certain natural hazards would further increase comparability by enabling like-for-like comparison across products.

Treatment of flood and water damage

³³ CALC Submission, 2017, Senate Standing Committee on Economics inquiry into Australia's general insurance industry. Available on [Senate website](#).



In many parts of Australia flood insurance is becoming increasingly unaffordable, as more accurate household level pricing by insurers and rising flood risk is resulting in consumers in flood affected areas being charged very high flood premiums. Currently, some insurers enable consumers to opt out of flood cover when purchasing insurance whilst other insurers include flood as a mandatory inclusion.

For option 2 to be effective, the baseline level of cover would need to both reflect a level of cover that consumers can expect to receive, but also be affordable. Flood risk represents a complication for this model. Flood is an important risk for which consumers would expect to be covered, however, it is an increasingly costly component of home building insurance. Recent large scale flood events have increased the cost of insurance, and flood and other natural peril insurance costs are often a large driver of insurance costs for households in affordability stress. In August 2023, the Actuaries Institute estimated that 12 per cent of Australian households were experiencing home insurance affordability stress, where affordability stress is defined as paying more than four weeks of household gross income towards home insurance premiums.

To ensure that the baseline product is affordable across Australia, the Government could mandate that insurers offer flood coverage on an opt out basis as part of the base product. Alternatively, the opt out could be broader and exclude all natural water-related damage.

Some stakeholders have noted that insurers and policy holders faced significant costs following the 2022 flood events to identify the sources of water inundation, particularly when differentiating between flood damage (as per the standard definition) and other sources of inundation such as storm or rainwater run-off. Given this, a baseline product that excludes natural water damage, whether it be caused by a storm, a flood or rainwater run-off may be more affordable and easier for consumers to understand. Damage caused by burst pipes or a broken dishwasher could still be covered by the product. Hail would also be proposed to be covered by the product, even though hail is comprised of water.

Other types of insurance

This option would also involve amending the Insurance Contracts Regulations to remove four of the five areas of general insurance to which the standard cover regime applies:

- Motor vehicle
- Personal accident
- Consumer credit
- Travel

The vast majority of concerns raised with Treasury during the targeted consultation relate to home building insurance, rather than motor vehicle, personal accident, consumer credit or travel insurance. Given this, it is proposed to no longer apply the standard cover regime to the other types of insurance. However, feedback will be sought through this process on the necessity of retaining the standard cover regime for these products.

Levels of standardisation

Were this option to be implemented, the Government would need to determine how standardised the baseline level of coverage should be. For instance, it would be possible to:

- Standardise only the events covered by the product;
- Standardise both the events covered and the definitions of those events;

- Standardise events covered, the definitions of the events as well as exclusions and allowances (such as accommodation allowances).
- Require insurers to offer a model insurance contract.

There is a trade-off between greater standardisation, which increases product comparability and potentially consumer understanding, and insurers' ability to undertake product innovation.

Option 3: Amend the standard cover regime to mandate a vertically differentiated rating system for home building insurance

This option would require insurers to classify their home building insurance cover into different tiers, with each tier configured to provide a predetermined minimum level of cover. An example of vertical differentiation that currently exists in Australia is the 'gold, silver, bronze and basic' tiers that were introduced to private health insurance in 2019.

Vertical differentiation was adopted in private health insurance to simplify product comparability for consumers. The scope of these tiers is based on minimum standard clinical categories, or standard definitions for certain hospital treatments. If a policy covers a certain clinical category, it must cover everything described as part of that category. For example, coverage offered under the 'bone, joint and muscle' category must include cover for bones, joints and muscles – insurers are not able to pick and choose which parts of the category they offer. Insurers are, however, able to offer additional coverage above the minimum requirements in additional 'basic plus', 'bronze plus' and 'silver plus' categories. Vertical differentiation in home building insurance could use a similar tier system, with a range of options for stratifying product offerings. Potential criteria could include, for example, the nature and duration of events covered, the standard of service provided, the value of debris removal, or the duration and value of temporary accommodation allowances.

While further consultation would be undertaken to determine the details of such differentiation, any effective rating system would rely on a number of key elements:

- A clear framework for stratifying product offerings into the separate tiers;
- An intuitive and easily comprehensible rating system, with clear differentiation between various offerings; and
- A baseline level of cover that would be appropriate for most instances.

In targeted consultation stakeholders identified both potential benefits and downsides to introducing compulsory vertical differentiation to home building insurance. One insurer noted that providing consumers with lots of choices could potentially result in more issues down the track, particularly if insurers do not increase their level of engagement with their products. Consumer groups also noted that vertical differentiation such as 'gold, silver, bronze and basic' tiers should not be relied on to be effective on their own, as they still require consumers to understand the difference between the policies. Some stakeholders also recognised that vertical differentiation had inequitable effects, as lower-socioeconomic consumers might only be able to afford the 'basic' or 'bronze' insurance product, despite potentially living in a hazard-prone area and actually requiring a more robust policy. Many stakeholders agreed that these problems currently still exist in the private health insurance market, which adopted mandatory vertical differentiation in 2019.

Mandating vertical differentiation would potentially give consumers greater certainty about the level of coverage they have. However, the extent to which this approach is effective would depend on how easy it is for consumers to understand the different tiers of cover.

As with option 2, this option would only apply to home building insurance.

Consultation questions

7. How well is the current standard cover regime achieving its intended purpose?
8. Which of the three options for intervention would best achieve the intended purpose?
 - : Repeal the standard cover regime in its entirety;
 - : Amend the standard cover regime to mandate insurers offer a baseline level of coverage for home building insurance only; or
 - : Amend the standard cover regime to mandate a vertically differentiated rating system for home building insurance.
9. Which of the three options is least likely to achieve intended purpose?
10. Are there any options to amend standard cover not listed above that you believe should be considered?
11. Should the standard cover regime be retained for insurance products other than home insurance?
12. Under option 3, on what basis should the various offerings be differentiated?

Next steps

Submissions

This consultation paper provides a consolidated summary of the issues, the underlying policy challenge, and possible directions forwards for government, industry, and consumers.

Treasury is seeking submissions from interested parties on the directions proposed and consultation questions outlined in this paper.

To contact us, please use the following contact addresses. Please note that Treasury does not intend to reply to each submission.

Closing date for submissions: 04 April 2024

Email	standarddefinitions@treasury.gov.au
Mail	Insurance Unit Financial System Division The Treasury Langton Crescent PARKES ACT 2600
Enquiries	Enquiries can be initially directed to standarddefinitions@treasury.gov.au

Specific questions may arise from this consultation which may have not been considered at the time of drafting. Treasury may undertake further targeted consultation with stakeholders if necessary.

After submissions close

Through feedback received from this consultation paper, Treasury intends to refine the preferred options for standard cover regime reform and the list of key terms and suggested definitions for standardisation.

It is intended that industry and consumers would collaborate with government in the next phase of options refinement, term selection and definition. Participation may be formalised through a technical working group or similar.

Where legislation is required to give effect to any options considered in this paper, exposure draft legislation will be released.

Appendix A: List of consultation questions

Standard definitions

1. To what extent is consumer misunderstanding of insurance policies leading to unintentional underinsurance or inappropriate insurance?
2. What are the consequences of not addressing these issues?
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?
4. Do you agree with the priority terms that are proposed for standardisation (fire, storm, stormwater, and rainwater run-off)?
5. For those terms that are proposed to be standardised, are there any exclusions that you believe should apply?
6. Are there any additional natural hazard terms you think should be standardised?

Standard cover

7. How well is the current standard cover regime achieving its intended purpose?
8. Which of the three options for intervention would best achieve the intended purpose?
 - : Repeal the standard cover regime in its entirety;
 - : Amend the standard cover regime to mandate insurers offer a baseline level of coverage for home building insurance only; or
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