

EXPLANATORY STATEMENT

Select Legislative Instrument 2012 No. 116

Issued by authority of the Minister for Financial Services and Superannuation

Subject - *Insurance Contracts Amendment Act 2012*

Insurance Contracts Amendment Regulation 2012 (No. 1)

Section 78 of the Insurance Contracts Act 1984 (the Principal Act) provides that the Governor-General may make regulations prescribing matters required or permitted by the Act to be prescribed, or necessary or convenient to be prescribed for carrying out or giving effect to the Act.

The Principal Act regulates the terms included in insurance contracts and insurer conduct in relation to such contracts. The *Insurance Contracts Regulations 1985* (the Principal Regulations) are the core regulations considered essential to the operation of the Principal Act.

The *Insurance Contracts Amendment Act 2012* (the Amending Act) amended the Principal Act to provide a legislative framework to allow a Regulation to be established which provide a standard definition of the prescribed event 'flood' for riverine flooding in home building and home contents (whether offered separately or in combined form) insurance contracts and contracts held by small business and strata title residences.

The purpose of the Regulation is to introduce a standard definition of flood for prescribed contracts to reduce consumer confusion regarding what is and is not included in insurance contracts. This will ensure that situations where neighbouring properties, affected by the same inundation event, will no longer receive different claims assessments because the policies covering them would use the same definition of flood.

In 2010-11 Queensland, New South Wales and Victoria experienced a number of severe flood events. These flood events coupled with other natural disasters including cyclone Yasi and the New Zealand earthquakes emphasized the important role the insurance industry plays in assisting individuals and communities return to normal after natural disasters. However, these natural disasters also highlighted the fact that many consumers lacked awareness regarding the extent of their insurance cover.

The Regulation will amend the Principal Regulations to define 'flood' and the classes of contracts of insurance to which the definition of 'flood' apply. The standard definition of 'flood' involves introducing a standard form of words to describe riverine flooding.

The Regulation will define 'flood' as the covering of normally dry land by water that has escaped or been released from the normal confines of any of the following:

- a lake (whether or not it has been altered or modified);

- a river (whether or not it has been altered or modified);
- a creek (whether or not it has been altered or modified);
- another natural watercourse (whether or not it has been altered or modified);
- a reservoir;
- a canal; or
- a dam.

While the Principal Regulations provide a definition of home buildings and home contents insurance that are appropriate for the purpose of providing a standard definition of flood, they do not provide interpretations of ‘small business’ and ‘strata title residences’. The proposed Regulation will amend the Principal Regulations to provide a definition of ‘strata title residence’ and criteria for determining whether a business is a ‘small business’ for the purpose of ensuring the standard definition of flood is provided.

Following the 2010-11 floods, the Government undertook targeted consultations with consumer groups, the insurance industry and the legal profession on insurance related matters. These consultations assisted the Government in developing the consultation paper ‘Reforming Flood Insurance – Clearing the Waters’, which included proposals for the introduction of a standard definition of ‘flood’ and the provision of one page key fact statements. This paper was released for public comment on 5 April 2011.

A total of 13 public submissions were received in response to the consultation paper.

On 9 December 2011, the Government released exposure draft regulations containing wording for the standard definition of flood. Nine submissions from key stakeholders were received in response to the exposure draft regulations. In consideration of the responses received a number of minor refinements were made to the Regulation.

Details of the proposed Regulation is set out in the Attachment.

The *Insurance Contracts Act 1984* specifies no conditions that need to be satisfied before the power to make the proposed Regulation may be exercised.

The Regulation will be a legislative instrument for the purposes of the *Legislative Instruments Act 2003*.

The Regulation will commence the day after it is registered.

The Minute recommends that the Regulation be made in the form proposed.

Authority: Section 78 of the
*Insurance
Contracts Act
1984*

Details of the proposed *Insurance Contracts Amendment Regulation 2012 (No. 1)*

Section 1 – Name of Regulation

This regulation will provide that the title of the Regulation is the Insurance Contracts Amendment Regulation 2012 (No. 1).

Section 2 – Commencement

This regulation will provide for the Regulation to commence the day after it is registered.

Section 3 – Amendment of *Insurance Contracts Regulations 1985*

This regulation will provide that the Insurance Contracts Regulations 1985 (the Principal Regulations) will be amended as set out in Schedule 1.

Schedule 1 – Amendments

Item [1] and Item [2] – subparagraph 10(a)(xi) and subparagraph 12(a)(xi)

Section 37B of the Principal Act (as amended by the Amending Act), provides that the regulations must define the meaning of flood for contracts to which Division 1A of Part V of the Principal Act would apply.

Division 1A requires a standard definition of the term ‘flood’ to be applied to all insurance contracts as prescribed in the Division. The provisions contained within Division 1A while acting independently remain consistent with other requirements in the Principal Act. A ‘prescribed contract’ for the purposes of Division 1A is an insurance contract included in a class of contracts of insurance declared by the regulations to be a class of contracts in relation to which Division 1A applies.

The terms and conditions of the standard cover regime in Division 1 of Part V of the Principal Act are set out in the Principal Regulations.

Regulation 9 and Regulation 13 declare respectively that home building and home contents insurance are classes of contracts of insurance to which the standard insurance cover regime in Division 1 of Part V of the Principal Act applies.

Regulation 10 and Regulation 14 specify those events that are declared to be prescribed events in contracts of insurance referred to in Regulation 9 and Regulation 13 respectively. Prescribed events incorporate a wide range of events that include ‘flood’, which is identified as a prescribed event in subparagraph 10(a)(xi) and subparagraph 14(a)(xi).

Item [1] and Item [2] will amend subparagraph 10(a)(xi) and subparagraph 14(a)(xi) to provide that ‘flood’ has the meaning given by regulation 29D.

Item [3] – Division 8

Item [3] will insert Division 8, which will define ‘flood’ and specifies the classes of contracts of insurance that are to use the definition of ‘flood’.

Regulation 29A - Definitions for Division 8

Regulation 29A will define ‘strata title residence’ for the purposes of Division 1A of Part V of the Principal Act.

A ‘strata title residence’ is defined to mean a residence to which the following apply:

- the portion of land on which the residence is located exists as the result of the subdivision of the title to a larger portion of land into separate titles for use for residential purposes; and
- property that is common between the residence and one or more other portions of land is managed by a single body corporate (however described).

The definition of ‘strata title residence’ that will be provided in this regulation will draw on definitions commonly used in State and Territory legislation, noting that laws relating to strata title residences fall within the jurisdiction of the States and Territories.

These properties can take a number of forms, from duplexes to gated communities to small and large apartment buildings. Individuals own a portion of the property and there is also common property, of which ownership is shared.

The regulation will also provide an example of an ‘owners corporation’ that will be drawn from descriptions in State and Territory legislation:

the title to the portion of land on which the residence is located is regulated under the law of the State or Territory in which the land is located as a ‘strata title’, a ‘community title’ or another description that refers to the title being created as described in paragraphs (a) and (b).

It is not intended that policies offered in respect of strata title properties that do not have a residential use be subject to the requirement to use the definition of ‘flood’. For example, a strata title property used exclusively for commercial purposes will be outside of the definition.

Regulation 29B - Small businesses

Regulation 29B will explain whether a business is a small business for the purposes of Division 1A of Part V of the Principal Act. This regulation will use two measures of business size; namely, current employee numbers and turnover, where turnover means turnover in the last completed financial year.

The determination of whether a business is a small business for the purposes of Division 1A of Part V of the Principle Act will be required to be made before a prescribed contract for the purposes of Division 8 is entered into.

Paragraph 29B(2) will specify that where turnover is known, a small business will be a business with a turnover of less than \$1 million and where the total number of hours worked each week by the employees of the business is no more than 190 hours.

The total number of hours worked each week will be calculated using total hours worked by employees of the business whether or not the employees are employed on a full-time, part-time or casual basis.

In calculating the number of hours worked each week, all relevant facts including the normal working hours required for the normal operation of the business would need to be considered.

Paragraph 29B(3) will provide for circumstances where a turnover figure for the previous financial year is not available. This could be due, for example, to the business being newly established or the turnover not having yet been finally determined. Where such circumstances apply, only the total number of hours worked each week by the employees of the business would be used.

Regulation 29C - Prescribed contracts

Section 37A of the Principal Act (as amended by the Amending Act), provides that the contracts to which Division 1A of the Principal Act (as amended by the Amending Act) will be declared by the regulations to be a class of contracts in relation to which this Division 1A of the Principle Act will apply.

Regulation 29C(1) will specify the classes of contracts of insurance to which the definition of 'flood' will apply.

These classes of insurance contracts will comprise insurance for home buildings and home contents (whether offered separately or in combined form); strata title residences and small business contracts that provide insurance cover (whether or not the cover is limited or restricted in any way) in respect of the loss or damage of or to the equipment, stock, inventory or premises of a small business.

The two key types of insurance contracts where it is considered to be critical for consumers to have a standard definition of flood are home buildings and home contents (both of these types of contracts are contracts to which standard cover applies).

It was also considered appropriate to include other similar insurance contracts that directly impact consumers. Therefore, the regulation declares insurance contracts covering small business and strata titles, as defined in the regulations, as prescribed contracts to which Division 1A of the Principal Act (as amended by the Amending Act) applies.

A small business for the purposes of Division 1A of the Principal Act will be a business that operates on a micro level and experiences similar difficulties to

residential consumers in processing complex policy documents as household residences.

In relation to strata title residences, the objective of the Regulation is to require that insurance policies offered in respect of residences utilise the standard definition of flood. As residences include strata title residences, it is appropriate that contracts of insurance for such strata title residences will be prescribed contracts for the purposes of Division 1A of Part V of the Principal Act.

Regulation 29C(2) will provide that a contract will not be taken to be in the class of contracts as outlined in Regulation 29C(1) if the contract was arranged by an insurance broker, if that broker was not acting under a binder. (A binder is an authority given by an insurer to an insurance intermediary to enter into, as an agent for an insurer, contracts of insurance on behalf of the insurer as the insurer.)

This exemption has been provided on the recognition that as brokers provide insureds (consumers that have insurance cover under a contract of insurance) with tailored advice and ensure that insureds have access to all of the information required to make an effective decision.

Regulation 29D - Meaning of ‘flood’ in prescribed contracts

Section 37B of the Principal Act (as amended by the Amending Act), provides that the regulations must define the meaning of flood for contracts to which Division 1A of Part V of the Principal Act applies.

Riverine flooding commonly refers to inundation caused by watercourses or catchments overflowing their banks due to a large area being subject to rainfall over a long duration.

Accordingly, the word ‘flood’ will be defined in paragraph 29D(1) to mean the covering of normally dry land by water that has escaped or been released from the normal confines any of the following:

- a lake (whether or not it has been altered or modified);
- a river (whether or not it has been altered or modified);
- a creek (whether or not it has been altered or modified);
- another natural watercourse (whether or not it has been altered or modified);
- a reservoir;
- a canal; or
- a dam.

The definition of ‘flood’ has been framed in a form that:

- will allow consumers to consider the extent to which the risk exists in their location;
- will be suitable for insurers to express either the inclusion or the exclusion of flood cover; and
- could be adopted by insurers without impacting negatively on the extent of flood cover currently provided.

The definition will apply to lakes, rivers, creeks and other natural watercourses regardless of whether they have been altered or modified. This will recognise that alterations and modifications do not fundamentally alter the nature of such watercourses.

The meaning of canals and modified natural watercourses within the definition will be considered to include infrastructure such as irrigation canals, drainage systems that have been constructed using natural contour lines or existing natural watercourses. Storm water systems such as street gutters and underground sewage systems are not considered to be canals or modified natural watercourses under the definition.

Paragraph 29D(2) will place a requirement on insurers offering insurance to businesses where the insurance contracts do not use the definition of flood provided in paragraph 29D(1) to take reasonable steps to ensure that the contract is not a prescribed contract. This will mean that insurers will be required to take reasonable steps to ensure the businesses being offered the contracts of insurance are not small businesses, before the contracts are entered into.

When determining whether a business is a small business for the purpose of Division 8 insurers will be required to consider all relevant information. In making the determination insurers will rely on information provided by the insured. The duty of disclosure provisions in the Principle Act will apply in relation to the provision of this information.

Insurers will only be required to take such steps where the definition of flood used is not consistent with that specified in proposed paragraph 29D(1). It will not be necessary for an insurer to verify business size where the contract of insurance offered utilised the definition of 'flood'. This will serve to minimise compliance costs for insurers.

Item [4] – Part 4 (Transitional arrangements)

Part 4 makes transitional arrangements in relation to amendments of these Regulations.

The amendments of these Regulations that will be made by Schedule 1, which relate to the use of the word 'flood' in certain contracts that provide insurance cover in respect of loss caused to a business and whether a business is a small business, will not apply for the period of two years commencing after this regulation commences.

The two year transitional period will provide industry with sufficient lead time to:

- update the content of product disclosure statements;
- retrain staff; and
- implement any necessary systems changes.

To provide industry with the opportunity to introduce the standard definition of flood after the commencement of this Regulation but before the two year transitional period has ended, this Regulation will provide that an insurer may rely on the Regulations, as amended by Schedule 1 in relation to a contract that provides insurance cover.

Statement of Compatibility with Human Rights

Prepared in accordance with Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011

Insurance Contracts Amendment Regulation 2012 (No. 1)

This Legislative Instrument is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

Overview of the Legislative Instrument

The purpose of the Legislative Instrument is to introduce a standard definition of flood for prescribed contracts to reduce consumer confusion regarding what is and is not included in insurance contracts.

Human rights implications

This Legislative Instrument does not engage any of the applicable rights or freedoms.