



The Specialists in Strata and
Community Title Insurance

A Strata Insurance Perspective

**Reforming Flood Insurance – Clearing the waters
Commentary on Proposals 1 and 2**

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Introduction to CHU

CHU Underwriting Agencies Pty Ltd was founded in 1978. Its two founding partners created the very first strata insurance plan in Australia and, unnoticed by its larger competitors, it calmly established itself as the number 1 strata insurance provider. CHU is the leading specialist in Strata and Community Title Insurance in Australia, with over 100,000 schemes and \$400 billion assets under its management.

CHU's reputation for strata specific expertise rests in its ability to reduce the financial risk and exposure for Bodies Corporate and Strata Managers. The CHU approach has been mimicked by some competitors and we have replicated our successful model in the USA, operating across 30 states and more recently, the CHU brand has been launched in the United Arab Emirates and UK markets.

In 2004 CHU became a wholly owned subsidiary of QBE Insurance (Australia) Ltd. QBE is one of Australia's most successful and secure insurance brands and a top 25 insurer, worldwide.

CHU remains at the forefront of strata insurance product development and its market leading cover is constantly reviewed, taking it beyond the minimum legislative requirements. To do this, CHU keeps abreast of National and State issues that affect the strata industry and this is why more strata managers, brokers and lot owners trust CHU with their strata insurance requirements than any other intermediary or insurer.

Over view

CHU's objective in preparing this submission is to comment on the matters raised from a Strata Insurance perspective specifically.

CHU is fully supportive of the initiatives expressed within the "Reforming Flood Insurance" consultation paper and welcomes the opportunity to put forward its views in relation to proposals 1 and 2.

Strata Industry Sector – the insurance purchase decision

The 2006 Census revealed that 22.5% of households live in strata and the evidence suggests this figure is rising, with almost 2,000,000 lots registered nationally.

Building (and other) Insurance for strata is compulsory under State legislation and the responsibility for arranging this rests with the Body Corporate. The Body Corporate affairs are managed by a Committee on behalf of the individual lot owners, who are automatically members of the Body Corporate. Membership to a Body Corporate carries with it an unlimited liability status for lot owners and in our experience, this important exposure is often unknown to them.

The Body Corporate Committee members can, and often do, delegate insurance matters to their strata managing agent. Given the usually long decision making chain behind the purchase of strata insurance, it's unlikely that the Standard Definition of Flood and Key Facts Statement in respect to residential strata insurance will reach the end consumer, the lot owner.

Given the unique complexities behind strata insurance decisions, the risks and exposures for lot owners and managers and the legal requirement to insure, CHU believes that it is important to contribute to the consultation process.

General comments

It would appear from the consultation paper that both the Standard Definition of Flood and Key Facts Statement are proposed for retail home building and home contents insurance only. It is unclear if the intention is to include Strata i.e. Bodies Corporate which are legal entities owned and managed by their members/lot owners.

CHU has compiled the following comments for the review committee.

- Strata does not strictly fit within the definition of Retail Client for purposes of s761G(5) of the Corporations Act. While the beneficiaries to certain additional special benefits may be individual persons, the actual client/insured i.e. Body Corporate is not an individual or a small business.
- Irrespective of this position, the current standard industry practice (and CHU practice) is to provide the insured (Body Corporate) with disclosure documents consistent with those a retail client would receive.
- The proposed standard definition of flood would assist Bodies Corporate and lot owners and CHU is supportive of this approach.
- The proposed Key Facts Statement would add an unhelpful level of complexity and confusion for Bodies Corporate. Given the nature and extent of cover provided under a Strata Insurance Plan, the Key Facts Statement has the potential to mislead Bodies Corporate with regard to cover and exclusions.

PROPOSAL 1 – STANDARD DEFINITION OF FLOOD

Whilst we acknowledge the initial proposal is for home building and home contents insurance, and residential strata would not form part of this proposal, any standardisation of flood definitions would likely be adopted by CHU wherever feasible.

General Approach

A) Q) Are the concerns noted above regarding consumer confusion about flood still valid?

- Yes, in respect of the lot owners living in strata, their view would be consistent with the home building and home contents consumer where much confusion is driven by media misinformation. The recent storms in South East Queensland represent excellent examples of this, including the recent Toowoomba storm associated event, which was erroneously referred to by media outlets and the ABC as an “inland Tsunami”.
- However, our experience shows that the insured in the Strata market i.e. Body Corporate is not confused. Their understanding of issues around flood cover is clearer because:
 - Most know that flood has never been part of the standard cover in strata policies
 - Strata policy wordings have clearly defined flood and it’s clearly excluded in both the PDS and Policy Wording
 - During disasters, we do not experience complaints or queries from Bodies Corporate or Strata Managers with regard to the absence of flood cover in our policy.
 - The use of professional advisers such as strata managers and brokers limits such confusion with the insured i.e. Body Corporate

B) Q) If so, is a standard definition of flood cover a suitable means of addressing consumer confusion?

- In relation to strata insurance, there are some variances in flood definitions and as such, a standard definition of Category B (riverine flooding) would address any confusion with lot owners.

What is the preferred form of the standard definition?

A) Q) Is the proposed wording of the standard definition appropriate?

- Yes.

B) Q) Are there different wordings or different approaches that should be considered?

- CHU is satisfied that the proposed approach to the definition of Category B (riverine flooding) will provide clear intent and clarification, however some minor refinement is

suggested. We would recommend paragraph A is extended as follows: “...modified, are named or unnamed, or normally dry that only run during periods of rain;”

A) Q) Should water escaping from water channels constructed within natural watercourses be treated in the same way as water escaping from natural watercourses for the purposes of the proposed standard definition?

- Yes.

B) Q) Does the language in proposed paragraph (a) cover those water channels, and if not, would it be appropriate to add some further elements to paragraph (a) or (b) to ensure that such water channels are included?

- To provide clear intent and clarification we would propose paragraph B is amended to read “a dam, reservoir, canal, or storm water channel.”

How could the proposal be implemented?

A) Q) Are there other options that should also be considered?

- It is suggested that the Insurance Contracts Act and/or Regulations as necessary could be amended to make explicit how an Insurer must interpret or define “Flood” (Category B – riverine flooding), not specifically under s35. This would essentially also amend the definition in relation to the standard cover regime, avoiding restricting application of the standardised definition to only those products within the standard cover regime.
- APRA/ASIC could provide a prudential standard or other regulatory guidance in respect of “Flood” and how it should be defined by licence holders.

B) Q) If the standard cover regime is not used as the platform for the standard definition, should the definition of “Flood” for that purpose also be aligned with the standard definition required to be used in policies?

- Yes, the definition should be aligned.

To what types of insurance policies should the proposed new rules apply?

A) Q) Are the considerations valid, and what other factors should be considered?

- Yes, a broader approach to the definition is in the consumer's interest. Having a consistent definition for both lot owners (consumers) and Bodies Corporate will lessen any potential confusion that may exist.

B) Q) If the scope of the rules were extended beyond home buildings and home contents policies, how should the broader class of policy be defined?

- The approach to a broader definition of class of policy should incorporate all insurance products utilising the term "flood" currently provided by entities licenced by APRA/ASIC applying only to consumers which insure with a APRA licenced insurer.
- The existing exemptions that apply to DOFIs and sophisticated consumers should not be effected.

How will the standard definition interact with other categories of inundation risk?

A) Q) Are there many cases of consumer confusion about flood cover unrelated to the application of Category B (riverine flooding risk)? If so, what is the source of the confusion?

- Yes, the source of such confusion presently is a result of variances in the treatment of Category A and B across different policies. However, we anticipate that standardising a definition for Category B would resolve any residual issues and confusion that may have existed with Category A.
- In respect to Category C, although not strictly related to Categories A or B (which are resultant from rainfall), the standardisation of the definition of Category B will not eliminate the existing confusion in relation to Category C.

B) Q) Are the possible advantages and disadvantages of standardising a broader spectrum of inundation risk noted above valid, and are there other factors that should be considered?

- There are possible advantages that clear definitions will significantly contribute to the reducing of consumer confusion.
- The terms in the proposed Category C have already been substantially defined through case law. The grouping of Category C inundation risks is not consistent with how these terms have been defined, and could in turn lead to greater confusion.
- In addition a disadvantage of defining the broad spectrum of inundation risk, is that this could lead to a lesser degree of cover being offered in the future.
- Looking specifically from a CHU perspective, our policy clearly defines and covers the inundation risk of Tsunami, and we would wish to continue providing the market with this cover. We question how this would be treated under any future definitions applying to the proposed broader spectrum of inundation.

- A final consideration, is that we would anticipate that the standardisation of Category C may result in further complexities for insurers with their reinsurance programmes.

PROPOSAL 2 – KEY FACTS STATEMENTS

We reiterate that the initial proposal and stated goals is for home building and home contents insurance, which does not extend to Strata Insurance. Any implementation of a Key Facts Statement for Bodies Corporate will be counterproductive by adding a level of confusion and complexity.

Policy Name

Q) Are there any disadvantages with a combined key facts statements where a PDS is also combined?

- Yes.
- Whilst there is no clear obligation for Residential Strata to receive a Key Facts Statement, any decision that Strata Insurers make to provide disclosure for Residential Strata consistent with a retail product will cause additional complexity and confusion.
- There is the real potential here to create additional costs to the consumer as it is more likely that insurers would look to unbundle products in order to meet the one-page A4 requirement. For example as CHU's residential strata policy is made up of 10 separate policies, it is not possible to include all the proposed information into a single page Key Fact Statement.
- In CHU's Residential Strata Policy, compliance with the proposed Key Facts Statement framework would result in a separate PDS for each of the 10 policies which are currently covered by a single PDS and Policy Wording. The current 16 page PDS would have to be multiplied by 10. Plus, the new requirement would also necessitate the repetition of the standard definitions and conditions which apply to each policy i.e. an additional 19 pages, constituting 35 pages per individual policy. This will increase our current bundled 104 page PDS & Policy Wording to an approximate 420 pages, separated into 10 pieces of documentation.

Policy Type

Q) Is the proposed treatment of policy type appropriate?

- No, in our opinion the treatment would lead to confusion for Bodies Corporate.
- The proposed terminology is incorrect and confusing as the insurance understanding of policy type is in reference to coverage i.e. accidental damage v defined events, rather than quantum.
- The reference to three types of quantum for basis of settlement will further confuse the consumer and in some markets, such as strata insurance, will convey the perception of alternate coverage that in reality is not available e.g. true replacement value cover for strata properties is not an option as all policies carry some form of sub-limits within the coverage.

How to use this statement

Q) Should the wording of a note on how to use the statement be prescribed?

- Yes.
- The "How to use this statement" section effectively describes the legal status of the Key Facts Statement vis-a-vis the PDS. This is an issue which will presumably be prescribed

through regulatory policy and potential legislative amendment. As such, it is our opinion that the wording of the section should be prescribed. Otherwise, each insurer's own view will be reflected in the wording and terminology - thereby creating confusion and potential additional exposure to the consumer.

What is covered

A) Q) What advantages and disadvantages would there be in prescribing events that should be addressed in the "what is covered" list?

- Whilst it seems a logical basis for all retail domestic insurance policies to be compared, and we agree that the methodology should be prescribed to avoid the document becoming a marketing document rather than guide, the current methodology suggested would not be feasible. To satisfy all the various state based statutory requirements relating to Residential Strata insurance cover, Insurers must provide cover via an "Accidental Damage Policy". Accordingly, the policies relating to property damage would simply state "Accidental Loss or Damage". Any reference to other forms of prescribed events would not clearly represent the policy.
- Accidental Damage policies provide broader cover and additional benefits to consumers not otherwise available via a prescribed/defined event loss cover.
- Any listing of prescribed events would make it highly unlikely that all derogations will fit on a single page as most policies are accidental damage covers that are subject to exclusions. Therefore the only way to show what is not covered i.e. derogations, would be to show all the policy exclusions under the "what is not covered" column as each exclusion has the potential to become a derogation against each of the events mentioned.

B) Q) Is the list of prescribed events in the standard cover regulations suitable for that purpose?

- No, this not suitable in the case of Residential Strata.
- Whilst the proposed approach appears logical to allow comparison of home building and home contents insurance policies, doing so on a prescribed events-basis would be misleading in the case of Residential Strata.
- As Residential Strata Insurance Policies are Accidental Damage Policies subject to exclusions, the differentiating factors from a Bodies Corporate perspective are the additional benefits provided by each insurer.
- It would be necessary to include "other" covers to allow the Body Corporate to differentiate between products. Without an option to include "other" covers the Key Facts Statement would be misleading.

C) Q) If an order of events were to be prescribed, what is an appropriate way to determine the order?

- In the case of Residential Strata, whether or not any order is prescribed would be irrelevant owing to the fact that policies are Accidental Damage policies subject to exclusions.

Q) Should there be any prescription of how the covered event is described in the list? What sort of rule could be appropriate?

- Yes, for Residential Strata the appropriate rule and prescribed event would be “Accidental Loss and/or Damage”.

Q) If a covered event is subject to a special benefit limit, should that limit be disclosed together with the covered event, in the adjacent “what is not covered” space, or otherwise?

- Yes, the existence or otherwise of any special benefit limits should be disclosed. However, as these amounts can be subject to change either in the PDS and/or the policy schedule, the actual limit should not appear on the Key Facts Statement. Rather, the consumer should be referred to the PDS and/or the policy schedule for the actual amount/s.

What is NOT covered

A) Q) Is it feasible, in a single page format, to require all derogations from standard cover to be mentioned in the “what is NOT covered” list?

- No, for Residential Strata Insurance policies this is not feasible because it would mislead the Body Corporate.
- Unfortunately it is highly unlikely that all derogations will fit on a single page as policies are Accidental Damage covers that are subject to exclusions. Therefore the only way to show what is not covered i.e. derogations, would be to show all the policy exclusions under the “what is not covered” column as each exclusion has the potential to become a derogation against each of the events mentioned.

B) Q) What other exclusions/conditions should be required to be included on the “What is NOT covered” list?

- Accidental Damage policies such as Residential Strata represent a unique issue.
- Given the way policy coverage is offered in today’s market, there is the very real likelihood that all exclusions would need to be listed, as an Accidental Damage type cover is only limited by whether an exclusion is applicable or not.

Possible alternative format for what is covered and what is not

A) Q) Is it feasible to summarise the key elements of home buildings and home contents policies in that format?

- Given we are responding in relation to Strata insurance only, we maintain the fundamental underlying issues in relation to Residential Strata around capturing the essential information within a single A4 page statement poses additional unique issues, due to the bundling of multiple policies, which means this is not feasible. Unlike home building and home contents, residential strata comprises a minimum of 6 or 7 policies bundled, specifically in CHU's Residential Strata policy it is 10.

B) Q) Would a list of prescribed events/risks in that format provide advantages, for comparison of policies or otherwise, compared to the "what is covered" and "what is NOT covered" lists set out in the draft sample key facts statement?

- There is no practical difference in implementing either format.

Need to consider risks

A) Q) Should the wording of this statement be prescribed?

- If the Key Fact Statement was to apply to Strata Insurance, this would need to be prescribed to ensure consistency between all insurer statements and eliminate arguments arising over the clarity of the wording.

B) Q) Would the statement be better placed as a generic statement on the reverse side?

- It would be preferable to place this statement on the front of the document as the intention is to promote greater consumer awareness and it is necessary to advise the consumer that it is the PDS and policy wording that contain all the information necessary for consideration.

Cooling off

Q) Should the wording of this statement be prescribed?

- Information relating to the cooling off period is already included in the PDS as prescribed in the *Corporations Act 2001* ('the Act'). The alternative for the Key Facts Statement may be a

simple prescribed sentence at the end stating the policy is subject to a cooling off period and directing the consumer to view the PDS for details.

Excess

A) Q) Is it feasible to require that a standard excess be disclosed (in dollar value), and a note to the effect that it may be varied (if applicable)?

- This could be difficult to achieve as many insurers will vary excesses from time to time or offer multiple excesses, therefore it may be more appropriate to state that the policy is subject to an excess / deductible and to refer to the policy wording or schedule for details.

B) Q) If there is a reference to the PDS, is it feasible to refer to specific pages/paragraphs, rather than to the PDS generally?

- Referring to specific pages/paragraphs could cause consumers to read their contract in parts or in isolation. It could also create additional costs to the product if the insurer changes its policy wording and then has to also amend the Key Fact Statement each time as well. It would be more appropriate to refer to any definition associated with excesses.

Matters for possible inclusion on the reverse side

A) Q) Are the above matters suitable to prescribe for inclusion on a generic reverse side?

- Yes they could be placed on the reverse side, however there would need to be a clear reference on the front page that the consumer needs to refer to the reverse side for more information.

B) Q) What other matters could be mentioned as part of such generic information?

- The generic information needs to be brief otherwise there is a risk that all information required will not fit into the suggested format. Any additional information over and above the suggested prescribed matters should also be prescribed in order to maintain consistency between all Key Facts Statements.

When should a key facts statement be provided to a consumer?

A) Q) When should a key facts statement be required to be provided, including telephone/internet sales?

- Ideally it should be made available in all forms with the ability to be supplied in both hard copy and electronic versions. For telephone/internet sales this could be made available on the website of the insurer.

B) Q) Could the document be incorporated into the PDS? Should this be required?

- No.
- It needs to be a separate physical document in order to be made available at any point on the negotiations otherwise it would be contrary to its intent which is to provide the consumer with a short form explanation of the policy coverage to which further details are available. Incorporating the document into the PDS would limit the proposed options for delivering a copy to consumers outlined in paragraph 78 of the Consultation Paper.

C) Q) What are the main advantages and disadvantages associated with the various options?

- Given the potential immediacy of the statement the ability to provide electronically would be the ideal method of delivery for efficiency, cost, and environmental reasons. Having said that a hard copy version should be also available to consumers as not all have the means to obtain electronically.

What should happen if a requirement regarding the key facts statement is not met?

Q) What is the appropriate sanction/remedy if an insurer:

A) fails to provide the key facts statement at the appropriate time: or

B) provides a key facts statement which is non-compliant with the requirements?

- There are clear remedies/sanctions that already exist within the Corporations Act and the ASIC Act in relation to the PDS and disclosure obligations, and it would sensible to have the same regime applied to the Key Facts Statement.

Relationship of the key facts statement to the PDS

Q) Is there any need to clarify or prescribe the legal status of the key facts statement – in particular its relationship to the policy terms and conditions in the PDS?

- The example of the “How to use this statement” section in the draft Key Facts Statement or something to this effect that is on the front page, together with any prescribed generic text included on the reverse side, would adequately cover this issue.

Rules on format

Q) Should there be prescribed in detail the format (for example, font size) for various items, or is it preferable to leave some flexibility in the presentation?

- One of the main issues that came out of the recent debates on flood was the fact that insurers did not clearly advise consumers in relation to flood exclusions or that such advice was not prominent enough. Without some form of prescription there is a risk that this situation will continue. Furthermore it is suggested that the purpose of this document is to provide clarity and factual information to the consumer. This requires consistency between the information provided by all insurers, otherwise there is a risk that the document becomes nothing more than another vehicle for insurers' marketing departments.

CHU Underwriting Agencies Pty Ltd

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