

03 September 2020

Ms Kate Carnell
Australian Small Business and Family Enterprise Ombudsman

Email: inquiries@asbfeo.gov.au

Dear Ms Carnell

Input to ASBFEO Insurance Inquiry launched in July 2020

Introduction

1. The Small and Medium Enterprise Business Law Committee of the Business Law Section of the Law Council of Australia (**SME Committee**) provides this input to the Australian Small Business and Family Enterprise Ombudsman (**ASBFEO**) Insurance Inquiry launched in July 2020 (**Inquiry**).
2. The SME Committee has as its primary focus the consideration of legal and commercial issues affecting small businesses and medium enterprises (**SMEs**) in the development of national legal policy in that domain. Its membership is comprised of legal practitioners who are extensively involved in legal issues affecting SME's.
3. Please note that the SME Committee's input may differ from that of other committees of the Law Council because of our Committee members' perspectives and experiences as advisers to SMEs.

Terms of Reference for Inquiry

4. The Terms of Reference for the Inquiry are framed as a list of questions being:
5. *That the Australian Small Business and Family Enterprise Ombudsman inquire into and report on practices of the insurance industry impacting small business and whether insurance products are fit for the purposes of small business, with particular reference to:*
 1. *the availability and coverage of insurance policies provided to small businesses including:*
 - *the impact of coverage denial;*
 - *policy exclusions and how they are communicated to small businesses;*
 - *the use of definitions in policy documents that create de facto policy exclusions;*

- *the fitness for purpose of market offerings;*
2. *other issues affecting availability and coverage including:*
 - *any impact of the current market's lack of diversity in insurance providers, underwriters and types of insurance;*
 - *insurance policy affordability and its impact on availability, including increases in price that amount to denial of coverage;*
 - *current models of government support or control in Australia and internationally that facilitate affordable access to appropriate insurance for small businesses;*
 3. *the role of brokers in getting the right coverage;*
 4. *the use of contract changes that have not been agreed to and their potential treatment as Unfair Contract Terms;*
 5. *the timeliness of payment of insurance payouts and the effectiveness of dispute resolution frameworks for insurance disputes; and*
 6. *any other relevant matters.*

Response and feedback

6. Thank you for the opportunity to provide input to the Inquiry. The SME Committee has sought to respond below to each of the questions listed as Terms of Reference for the Inquiry.
7. The SME Committee submits that it is very important in the ASBFEO reviewing insurance for small business to appreciate that insurance cover for small business risk requirements are issued by insurers under general insurance policies, which are legally new contracts at each renewal. This differs from life insurance policies which are continuing contracts that may apply for many years. Consequently, each year a small business has the opportunity to seek to change any of the terms and conditions under any of its annual general insurance policies.
8. The Committee also submits it is important for the ASBFEO to recognise that the Insurance Council of Australia (**ICA**), the industry representative body for general insurers, and its constituent members have undertaken a considerable amount of work in recent years to seek to improve the practices of general insurers in dealing with insureds, including small business. Accordingly the General Insurance Code of Practice (**GI Code**), which covers a range of general insurance products that would be applicable to small business including business insurance, public liability insurance, industrial special risks insurance and other commercial insurance products, covers most aspects of an insurer's relationship with its insureds. Compliance with the GI Code by general insurers which have subscribed to the GI Code is monitored independently by a business unit in the Australian Financial Complaints Authority (**AFCA**).

The availability and coverage of insurance policies provided to small businesses

9. The SME Committee is aware that the availability of global reinsurance coverage for a range of business risks has been noticeably impacted by constraints for Australia over the last couple of years particularly in financial services where the outcomes of the Hayne Royal Commission have caused increases in claims to cover compensation and the number and value of claims

for class action litigation has increased, and in other areas, including housing and small business have had claims increases impacted by natural disasters being bushfires, floods and severe storm damage, as well as a consequence of the slow down of economic activity, both domestically and globally, due to the COVID 19 pandemic.

10. Although from the observations of the SME Committee, insurance cover for small business remains available from general insurers who reinsure globally with a large range of reinsurers, thereby spreading their risk of not being able to fund benefit claims under policies they issue, the price of some insurance cover has considerably increased. Insurance cover for flood, for example, may have been denied, or the premium payable increased prohibitively, until such time as improved drainage or flood prevention measures are put in place for future flood events. The industry knowledge as to which insurers provide the most appropriate cover and pricing for small business tends to sit with insurance brokers.
11. The SME Committee notes that it would be prudent for a small business only to deal with general insurers which have subscribed to the GI Code, a list of which is maintained on an ICA register.
12. The ICA represents around 95% of general insurers in the private sector.
13. The SME Committee references the July 2015 Report on Non-Insurance in the Small to Medium Sized Enterprise Sector that can be found on the ICA website, which indicates that the vast majority of small businesses have insurance cover, and sets out the statistics and reasons for non insurance, including information on the business areas non insurance most occurs.
14. Insurance cover for small business is a specialist area of general insurance, and is provided on an individual policy basis, unless the small businesses are part of a group policy provided through their industry representative organisation. Group insurance policies provide pooled risk cover, with premiums set by the insurer based upon the insurance experience of the group, which means those in the group who make fewer claims will effectively subsidise those who make the most claims.
15. Individual insurance policy cover, and group cover, is provided by a general insurer based upon a number of criteria that impact the likelihood and cost of the insurer having to pay out benefits for claims under the policy with an actuarial assessment of the cost to the insurer feeding into the price (premium) the insurer charges for cover. One of the main elements considered is the claims experience of the insured, and this element seems to be relatively well understood by insureds. The more claims made and the higher the value of those claims, the higher the premiums will be in future.
16. From the experience of the SME Committee, insurance cover, whilst it is an important mechanism by which small business mitigates its financial risks, is generally not the only risk mitigant used by small business, nor often is it the main risk mitigant. Small business will generally deal with its risks in a pragmatic manner, so as only needing to rely on insurance cover as a last resort, where it was unable to control the risk mitigation itself.
17. By way of example, the SME Committee refers to the professional indemnity insurance legal practitioners are required to have to practice. Most legal practices have robust risk management frameworks, policies and processes to seek to ensure the need to utilise their insurance cover occurs rarely.

18. If an application for cover has been made to an insurer that provides cover for small business, from the experience of the SME Committee, the main reason for an insurer to deny cover, to exclude cover for certain aspects of the cover applied for or to impose conditions on cover is that as a consequence of the insurer's underwriting process, by which the insurer assesses its risk based a range of criteria, the insurer forms a view that it is not prepared to accept the risk the small business is applying to have covered, or will accept only a component of that risk, or will only accept the risk if conditions are imposed.
19. In any of these circumstances it can be valuable for the small business to have applied through an insurance broker, who will know which insurer is likely to deny or exclude cover or impose conditions, and can work with the small business to reduce the risk of that occurring, including providing options the small business may otherwise not consider.

Other issues affecting availability and coverage

20. The July 2015 ICA Report on Non-Insurance in the Small to Medium Sized Enterprise Sector notes in particular the impact of State stamp duty on the cost of insurance cover for small business, and that if stamp duty was to be removed, non insurance rates would decrease.
21. The SME Committee notes that for general insurance that is mandatory for business, including for small business, such as workers compensation insurance, although historically businesses were able to source their own cover, it has been the trend over recent years, including particularly in New South Wales, for the government to seek to reduce the costs to business for such cover, and improve the efficiency of the insurance administration processes, particularly the claims experience processes for employees who benefit from the cover, by legislating to effectively centralise those processes, have them undertaken as an administrative function, reducing the inclusion of lawyers in the process and setting coverage expectations based upon formula referenced to the degree of injury suffered.
22. At this point, however, given the *icare* issue that has recently come to light in New South Wales, it is difficult for the SME Committee to comment as to whether this approach could benefit insurance cover for small business.

The role of brokers in getting the right coverage

23. The most valuable reason for small business, in the SME Committee's opinion, to use insurance brokers who specialise in the insurance requirements of small business is the industry knowledge those brokers bring as to which insurers provide the most appropriate cover and pricing.
24. The other main reason for small business to use insurance brokers is that these brokers can undertake, or assist the small business in undertaking, most of the administrative activities the small business as an insured is required to meet under the policy, and is usually paid for these activities by the insurer, not by the insured small business. These activities can include detailing information on the value of assets to be covered by the policy, claims history and confirmation of risk mitigation processes, which a small business may find difficult to undertake by itself.
25. Although following the Hayne Royal Commission there was a concern that payment of insurance brokers by the insurers should cease as being conflicted remuneration that could influence the broker's recommended insurer, once the degree of value that the brokers provide to the insureds was understood, this concern was alleviated.

The use of contract changes that have not been agreed to and their potential treatment as Unfair Contract Terms

26. The SME Committee notes that following the extension of the unfair contract term laws to apply to small businesses from 12 November 2016, consideration has been given by government to include insurance contracts under the unfair contract terms legislation. The SME Committee made submissions on such proposed extension of unfair contract term laws to insurance contracts, supporting the extension and recognising the integral importance to small business of managing risks through having appropriate and certain insurance cover.
27. Legislation to implement this extension has been passed by Federal Parliament, with the new laws coming into effect from 5 April 2021. In the meantime, general insurers who issue policies to small business should be reviewing the terms and conditions of the policies under which they provide cover for small business risk requirements to ensure that by the date the new unfair contract term laws for insurance contracts come into effect any potential unfair terms should no longer exist in these policies.
28. The SME Committee notes that for general insurance policies, each year a small business has the opportunity to seek to change any of the terms and conditions under any of its annual general insurance policies.
29. In circumstances where an insurer has a 'template' policy it provides to small business insureds to cover certain of their risk requirements, those policies should be considered as 'standard form' contracts for the purposes of the extended unfair contract term laws. An insurer that issues such policies should, to mitigate its own risk of having a policy term that is found to be unfair and therefore not able to be relied upon by the insured, ensure such policies do not contain terms that may be found to be unfair.
30. Since the unfair contract term laws were extended to small business, the ACCC has made it very apparent that any contract term that allows a party to change the terms of the contract without the knowledge or consent of the other (small business/consumer) party will be considered to be unfair.
31. The general insurance policies currently issued to small business must comply with the requirements of the *Insurance Contracts Act 1984* (Cth) which includes an obligation to act with utmost good faith, which means the insurer must deal with the insured honestly, and must not mislead the insured or withhold critical information. In the SME Committee's view, any instances that the ASBFEO has come across where the terms of an insurance policy have been changed without the agreement of the insured would likely constitute a breach of the insurer's good faith obligation under that Act. It could be, however, from the experience of the SME Committee, that although the insured thought the change had been made without their agreement, the insurance policy contained a provision that allowed the insurer to make changes in certain circumstances, and the insured had either not read the policy or had forgotten the provision existed.

The timeliness of payment of insurance payouts and the effectiveness of dispute resolution frameworks for insurance disputes

32. The SME Committee refers the ASBFEO to the GI Code, and to the procedural requirements of AFCA for the compliance obligations that general insurers must meet for both insurance

payments and for dispute resolution requirements. In addition, legislation for new internal dispute resolution obligations has been passed and will come into effect from 5 October 2021.

Any other relevant matters

33. The SME Committee notes that general insurers in Australia are regulated by the Australian Prudential Regulation Authority (**APRA**), both by legislation and under APRA Prudential Standards that cover a range of detailed procedural requirements that the insurer must comply with and for which penalties can be imposed for contravention. These obligations not only apply for consumers, but also for small business and if ASBFEO continues to be concerned about the treatment of small business by general insurers, it could benefit by approaching APRA and seek that regulator's assistance to deal with the issues through changing the behaviours of the insurers.

Further discussion

34. The SME Committee would be happy to discuss any aspect of this feedback. Please contact [REDACTED], Chair of the SME Committee, on [REDACTED] if you would like to do so.

Yours faithfully



Greg Rodgers
Chair, Business Law Section