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Dear Sir/Madam

Responses to consultation questions from ICA Independent Paper on Commercial Insurance Issues for SMEs - May 2021

The Small and Medium Enterprise Business Law Committee of the Business Law Section of the Law Council of Australia (**SME Committee**) provides in this letter its responses to the consultation questions from the Independent Paper on the Role of the Private Insurance Market – Independent Strategic Review: Commercial Insurance, Consultation Paper particularly dealing with small businesses and medium enterprises (**SMEs**) issued by the Insurance Council of Australia (**ICA**) in May 2021 (**Paper**)

The SME Committee has as its primary focus the consideration of legal and commercial issues affecting SMEs including 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 SMEs.

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.

The Paper

The Paper was commissioned by the ICA to inquire into and provide a summary of potential practical initiatives to be explored that could result in solutions to commercial insurance problems that SMEs in particular have found challenging for some years. The Paper focuses on four (4) key topics that impact on these problems being affordability, availability, market failure and government intervention, provides information on potential practical initiatives for solutions to problems and then raises consultation questions with regard to such initiatives.

The SME Committee submits that it is very important in the ICA reviewing insurance for small business to recognise that commercial insurance cover for small business risk requirements is 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.

The Committee also recognises, as does the Paper, that a considerable amount of work has been undertaken in recent years to seek to improve the practices of general insurers in dealing

with insureds, including small business. The General Insurance Code of Practice (**GI Code**), which is not mandatory and was essentially developed to deal with consumer issues, but which by definition also includes small businesses covers a range of general insurance products that are applicable to small business as well as most of the practical aspects of an insurer's relationship with its insureds.

The SME Committee commends the ICA for commissioning the Paper and acknowledges the comprehensive and valuable analysis the Paper contains with regard to the insurance issues that have recently become the most challenging and concerning for small business.

As does the Paper, the Committee recognises that the Australian Small Business and Family Enterprise Ombudsman (**ASBFEO**) has also recently undertaken a review of insurance issues of concern for small business, and the Committee also provided a response to that review.

Aside from working with insurers who provide commercial products for small business, and who are often constrained by their reinsurance arrangements or their commercial profit imperatives, the SME Committee notes that proposals for small business industry bodies to organise mutual insurance arrangements, as opposed to group insurance cover, is also being explored to potentially provide a sustainable solution to the current concerns for small business.

Response and feedback

Thank you for the opportunity to provide responses to the consultation questions raised in the Paper. The SME Committee has sought to respond below to each of the questions where it is able to.

Affordability – Cash Flow Dimension

Q2.1 How widely available are premium instalment options for SME businesses?

As far as the SME Committee is aware, most of the large general insurers that offer specialist commercial insurance products for small business also provide options for premium payments by instalment. Given that, should the premium be paid upfront at the start of the policy, the insurer would need to periodically allocate over the period covered by the policy portions of premium as earnings. Consequently, receipts of premiums by instalment, so long as the insurer's systems have functionality to accept instalments, should be available to enable small business to more accurately manage its cash flow, should it need to do so.

Q2.2 In what circumstances and to what extent are the absence of premium instalment options a barrier to SME customers in purchasing insurance or purchasing adequate insurance?

From the experience of members of the SME Committee the funding by way of a lump sum by small business of a premium under a commercial insurance policy may impact cash flow for a small business if it has not been properly budgeted for the future payments. Budgeting becomes more difficult when an insurer increases the premium considerably compared with past years, as recognised in the Paper in discussing affordability concerns.

The SME Committee understands that in such circumstances, where premium instalment options are not available from their general insurer for the commercial insurance product they require, the small business would generally initially look for an alternative insurer with either a lower premium or an opportunity to pay by instalments. From the Committee's experience it would only be if the small business was unable to source the cover required at an affordable

premium, or payable by instalments, that it would then consider reducing the level of cover provided, or in the extreme, choose not to take out cover.

Q2.3 What are the pros and cons of premium funding facilities that are contracts not associated with the insured?

The SME Committee recognises that in the circumstance where no premium instalment options are available and a small business does not have the ability make a lump sum premium payment without seriously impacting its cash flow requirements. This is a circumstance that should be relatively uncommon. It may occur where an insurer determines it needs to make a large increase in a premium, a premium funding facility could provide the small business with an acceptable solution to have the premium paid, thereby effecting the insurance cover required, albeit incurring a charge for accessing that premium funding.

The SME Committee notes that this solution does not differ in practical terms from a small business accessing an overdraft facility with its bank for the purpose of funding an unexpectedly increased lump sum insurance premium.

Availability v affordability

Q3.1 Do you accept that, in general, insurance that is available but unaffordable is fairly priced?

a. If yes, do you have any counterexamples (i.e. not fairly priced)?

The SME Committee notes the discussion in the Paper as to what is considered to be unaffordable, which recognises that different circumstances and experience may consider unaffordability in different ways. Having said that, the experience of members of the SME Committee who have worked with and for general insurers is that most seek to price their product competitively in the market at a level they assess should provide insureds with an acceptable price while enabling the insurer to cover its costs in providing the product as well as making a reasonable profit.

If a commercial insurance product is seen by the market as unfairly priced, as well as being considered unaffordable by small business insureds, the product take up would be very low and the insurer would then need to either reduce its product price to gain some take up, or cut its losses and withdraw the product.

b. If no, please elaborate.

Criteria for government intervention

Q3.2: Is this set of suggested criteria for government intervention a sound reference point for dialogue between the insurance industry on the one hand and, on the other hand, insurance buyers and governments or government agencies?

The SME Committee is of the view that the criteria suggested in the Paper as to when government intervention in the private insurance market should be justifiable and the goal to be achieved by such intervention is an acceptable sound reference point for dialogue between the insurance industry on the one hand and, on the other hand, insurance buyers and governments or government agencies.

The Committee also recognises that in a crisis situation this goal may change as would the basis of reference for such dialogue. The economic responses by the Federal and State

governments to the current COVID-19 crisis have demonstrated that intervention previously considered inappropriate may have a valuable place in maintaining market stability in times of extreme crisis.

In particular, the SME Committee recalls that following the collapse in March 2001 of HIH as a general insurer that provided a substantial proportion of the Australian market compulsory professional indemnity insurance for, amongst others, the legal profession, the New South Wales government intervened to establish a specialist general professional indemnity insurer for the NSW legal profession. Such necessary intervention may bring with it consequences that may not necessarily occur within a completely competitive market if not appropriately regulated..

Q3.3: If your answer is no, how or in what circumstances might the framework be modified and for what purpose(s)?

Documentation, definitions and policy wordings

If an industry-wide approach is to be sought to different and improved documentation, including elements of standardisation and better adaptation to customer needs –

Q5.1. To what extent would the introduction of standard definitions and standardised wordings, along the lines of options (a) and (b)–

(i) improve underwriting efficiency?

The SME Committee notes that differences between underwriting requirements of different insurers for similar commercial insurance coverage is generally attributable to the differing requirements of their reinsurers.

Accordingly, the Committee notes that any standardised definitions and wordings introduced for underwritten commercial insurance products, which the Committee supports so as to provide certainty and improve comparability between insurance products for small businesses, would also need to flow through to all the reinsurers of those commercial risk coverages so as to ensure there were no gaps between the policy liability obligations of the primary insurer to the small business insured and the policy liability obligations of all the reinsurers to the primary insurer. Such gaps could cause the primary insurer to raise its premium to ensure it has access to sufficient funds to make payment should a claim arise for a gap risk.

(ii) enhance competition or stifle competition (and how)?

The SME Committee strongly supports the standardisations for commercial insurance policies for small businesses as are set out on pages 43 and 44 of the Paper including the suggestion that the ICA introduce a system of mandatory standards and non-binding guidance notes along the same lines as the Financial Services Council. The SME Committee recognises the benefits such standardisations will provide to small business in that they will have certainty of cover and circumstances for claims, thereby reducing any concerns suffered as to whether the commercial insurance they are paying for is appropriate for their requirements.

As a consequence, competition between the insurers providing commercial cover to small business will focus on price, which should be reflective, as noted in the paper, of a number of relevant criteria but particularly claims history of the insured and potential increases in claims payments due to market or climate impacts on the costs of claims.

If, as the Paper suggests, Affordability Guides could be introduced together with explanatory materials to educate small business owners, or enable insurance brokers for small business owners to better understand and explain to small business owners how premium affordability insurance principles apply to their small business, the SME Committee would expect competition in the small business commercial insurance market to become more transparent and efficient resulting in fair and appropriate product premiums.

(iii) stifle (or enhance) innovation?

The SME Committee recognises that standardisation of a product would generally reduce opportunities for innovation in the product by the product issuer in favour of benefits to the insured by way of improved administration efficiencies and fairer affordable premium pricing.

(iv) make a material difference to the understanding and ability of insurance buyers to make their insurance decisions?

The SME Committee considers that standardisation of policy definitions and wording, together with educational and explanatory materials should allow small business owners to better understand the commercial insurance cover appropriate for their small business as well as the premium affordability insurance principles applicable to their small business, and should consequently make a difference to their ability to make insurance decisions.

However, the SME Committee is aware that despite the provision of valuable education materials and support information available for small business owners from a number of sources and on a number of topics (not insurance, but other important topic areas for small business), small business owners generally do not have the time or energy after conducting their business activities, to deal with these 'non-core' issues themselves, and are more inclined to engage the services of a person they consider has the required expertise to assist them, which for commercial insurance needs is an insurance broker who deals with small business clients.

Q5.2. How far should the insurance industry proceed in the direction of options (a), (b) and (c) and why?

The SME Committee considers that standardisation of policy definitions and wording and agreed 'fit for purpose' standard policy design to meet the requirements of small business by industry, together with the Guidelines suggested in the Paper for underwriting should result in benefits to the insured by way of improved administration efficiencies and fairer affordable premium pricing.

The SME Committee notes, however, the GI Code is not mandatory, and that from the experience of Committee members the prospects of having all insurers who provide commercial insurance products for small business agreeing to standardise their product designs including for specific industry requirements, would be fairly remote. Even if they agree, as has occurred with life insurance, to standardise definitions and wordings, general insurers will need to look for their reinsurers to also agree to standardisations.

Q5.3. Which elements of options (a) and (b) are the most important and why?

The SME Committee considers the following suggestions from a) and b) to be the most important because they would lay a strong foundation for later expansion of obligations to be imposed on insurers to narrow the range of current concerns experienced by small business:

- standard definitions and wording for basic insurance policy requirements across the industry for commercial insurance cover for small business;
- clear descriptions of policy exclusions, inclusions, limitations and conditions;
- checklists;
- risk mitigation initiatives available to small business insureds; and
- historic reasons for claims failures.

Q5.4. Are there other worthwhile underwriting initiatives, different from the ideas at option (c) and in the absence of new regulation, that would be effective and why?

The SME Committee is of the view that it may be beneficial for industry representatives of small business cohorts to commission an actuarial review to provide data on risks and claims for that industry cohort. This would be done with a view to putting in place a group insurance policy for that cohort with automatic insurance cover levels for critical commercial insurance for that cohort, rather than each cohort member needing to be underwritten.

The approach has been used for many years in the group life insurance industry with great success and is reliant on the cross-subsidy effect of pooling insurance coverage.

Q5.5. How useful or how valuable to each of customers, brokers and insurers would be ICA standards and guidance notes, as suggested at option (4), assuming they are well constructed and do not contravene competition laws?

The SME Committee considers ICA standards and guidance notes as suggested would be very valuable as insurers could look to these to become compliance obligations going forward, as they do with FSC standards. They would also allow customers and brokers some reference for underwriting requirements and claims requirements.

Options for Evaluation

The goal of this paper is to obtain views via consultation on the question: what is the potential for each option to improve affordability and availability?

Therefore, for each of the options described in this Section, this question can be considered for each of PL, PI property insurance, and BI for each segment of the SME market that is struggling to find affordable insurance available on suitable terms and conditions.

More specifically, and noting that none of these options are mutually exclusive, for each option and for each market segment (industry or profession) in which you have an interest–

The SME Committee represents lawyers who have small business clients, and comprises lawyers who are generally small business owners themselves. Consequently, the answers below reflect experience from both these sources and confirms that responses for the questions below for Options 1, 2, 5 and 16 have been covered in the answers provided above.

Q.5.6. What are the potential benefits and how effective might the option be?

Option 3 and Option 10 – Brokers and remuneration and specialisation

From the experience of members of the SME Committee, and as mentioned in the Committee's response to Q5.1(iv) above, small business owners generally do not have the time or energy after conducting their business activities, to deal with these 'non-core' issues themselves, and are more inclined to engage the services of a person they consider has the

required expertise to assist them, which for commercial insurance needs is an insurance broker who deals with small business clients.

Accordingly, it can be valuable for the small business to have applied for commercial insurance cover 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.

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.

Although following the Hayne Royal Commission there was a concern that payment of insurance brokers by the insurers should be ceased 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 SME Committee recognises that insurance brokers who specialise in small business commercial insurance are an invaluable source of support for small business owners.

Despite the ASBFEO suggesting that commissions payable to insurance brokers be banned, it is the position of the SME Committee that commissions payable to insurance brokers should not be banned as these insurance brokers provide a very valuable service for small business owners. Like mortgage brokers, whose commissions at one point were to be banned until the basis for these commissions were properly explained and the benefits of the services they provide understood. Insurance brokers should be seen in a similar light to mortgage brokers.

Option 4 – Greater use of excesses and deductibles

The SME Committee concurs that these aspects of policy design to reduce premiums are appropriate for small business commercial policies, so long as the insured is made aware of how these apply.

Options 6, 7 and 8 – Underwriting consortia (like Lloyds), underwriting agencies and specialist capabilities and group captives and discretionary mutual funds

The SME Committee notes that consortia like Lloyds have mostly removed themselves from the Australian market in the last couple of years, as recognised in the Paper. The Committee agrees that underwriters with specialist knowledge of small business industry activities and risks are a valuable source of information to enable insurers to provide appropriate commercial insurance cover for small businesses.

The Committee considers that given small businesses individually lack bargaining power and often find their individually underwritten commercial cover premiums may not be affordable, the suggestion for small business to look to group commercial insurance coverage based upon industry cohorts could be a sensible approach that enables the pooling of risk profiles by the insurer, and consequent averaged cover for each member of the cohort.

As noted in its response to Q5.4 above, the Committee is of the view that it may be beneficial for industry representatives of small business cohorts to commission an actuarial review to provide data on risks and claims for that industry cohort with a view to putting in place a group insurance policy for that cohort with automatic insurance cover levels for critical commercial insurance for that cohort, rather than each cohort member needing to be underwritten.

Option 9 - Industry association accreditation and standards

From experience, the SME Committee recognises that one of the best ways to improve risk mitigation practices of a cohort of insureds so that the insurer can reduce premiums for cover under commercial policies is to require the insureds to introduce and maintain risk management requirements as part of their industry association accreditation or have them as standards to be met for cohort membership. Examples include the FSC, AICD, Tax Practitioners Board, Law Society NSW (for LawCover), ANZICA and many others.

Option 14 – Government Charges and Taxes

The SME Committee considers that the inclusion of charges and taxes from government in premiums for commercial insurance policies for small business has little bearing on whether the insured takes out the policy or whether the coverage provided is appropriate. However, reduction of premiums by removing or reducing these charges and taxes would assist small businesses afford commercial cover.

Option 15 – Collaboration with government to reduce regulatory barriers

The Committee concurs with this option.

The Committee has not provided input with regard to Options 11, 12 or 13.

Q.5.7. What are the potential costs and the weaknesses or limitations of the option?

The Committee has not provided information on costs for options and has included weaknesses and limitations as appropriate to its responses.

Q.5.8. Which combinations of options do you believe are worth pursuing to deliver a material change in the affordability and availability profile of the risks in which you have an interest in 2021?

The SME Committee notes that it would be prudent for a small business to only deal with general insurers who have subscribed to the GI Code, a list of which is maintained on an ICA register.

The ICA represents around 95% of general insurers in the private sector.

The SME Committee is of the view that in 2021 the ICA should flag that it will be introducing the standardisations as set out in the Paper including through additions to the GI Code.

The SME Committee considers it may be beneficial in the future for the ICA to make the GI Code mandatory for its members to ensure the requirements of the GI Code are complied with by as many general insurers as possible in Australia.

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;
- having 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.

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.

Q.5.9. For each of the options you wish to see pursued, what process and what resources do you suggest be applied to see it implemented?

For the standardisations suggested in the Paper, the SME Committee acknowledges that the ICA should be able to action the inclusion of these through additions to the GI Code.

For the option suggested of group industry cohort data and group commercial insurance cover, the SME Committee recognises that relevant industry representative bodies would need to assess and progress this option to benefit their small business cohort members, and that specialist negotiations may be required with insurers willing to look at providing this type of cover.

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.

Q.5.10.9. For Option 13 – BI insurance – what kind of insurance industry initiative might be taken to improve the further understanding and functionality for BI insurance for SMEs?

The SME Committee considers that given the number of extraordinary events that have caused interruptions to small businesses in the last couple of years in Australia, it is opportune for the ICA to organise for an assessment to be made by the insurance industry of business interruption triggers for small businesses in areas for which small businesses do or could maintain commercial risk insurance cover with an emphasis on the impacts such interruptions have had on small businesses from the recent drought, bushfires, floods and COVID -19 crises.

Finally, 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 concerns about the treatment of small business by general insurers could benefit by approaching APRA and seeking that regulator's assistance to deal with the issues through changing the behaviours of the insurers.

Further discussion

The SME Committee would be happy to discuss any aspect of this feedback.

Please contact Coralie Kenny, Chair of the SME Committee, on 0409 919 082 if you would like to do so.

Yours faithfully

A handwritten signature in black ink, appearing to read "Greg Rodgers". The signature is written in a cursive style with a large, prominent 'G' and 'R'.

Greg Rodgers
Chair, Business Law Section