

Insurance Australia Group – Response 2009 Victorian Bushfires Royal Commission The Fire Services Levy and Insurance - Discussion Paper

1. What are the advantages and disadvantages of requiring insurance companies to fund a major part of the fire services?

Insurance Australia Group (IAG) believes that it is difficult to find advantages for insurance policy holders to fund a major part of the fire services.

The current regimes for the taxation of insurance are an historical anachronism that is indefensible upon the generally accepted principles of taxation of simplicity, efficiency and equity. These tax regimes are inappropriate, regressive and based on historical circumstances rather than any concept of tax equity. These regimes contribute to under-insurance and non-insurance, with consequential negative fiscal impacts when the public purse is inevitably called upon in times of the majority of climate related disasters.

The fire services levy is a poorly targeted mechanism for distributing the cost of fire services and not considered equitable. Indeed, data shows there is no correlation between the average levy collected and the incidence of fire callouts. This reflects the fact that the levy is imposed on the total premium - which includes the full range of perils including storm and theft - and not just that proportion associated with fire.

IAG believes a fire services funding system, which encourages full value insurance, would result in economic and community benefits, especially as regards under-insurance. A system that is fair, consistent and more understandable to taxpayers and the community at large is needed. More equitable and appropriate emergency services funding models exist in Western Australia, Queensland and South Australia.

IAG believes that the most effective way of achieving this end, is to implement a system that sees all property owners sharing the responsibility for funding fire services.

2. What are the advantages and disadvantages of applying a levy to non-insured and under-insured properties (whilst maintaining FSL on other properties)?

Such a proposal faces practical challenges, and the potential disadvantages outweigh the advantages, particularly for the Government in terms of implementation, privacy, compliance and enforcement. In our view the costs will far outweigh any benefits to the industry, the Government and the community at large.

Indeed, as the *Discussion Paper* highlights there are key difficulties in identifying non-insured and under-insured properties. The model would pose some challenges and would be difficult to implement practically. There would be extensive cost in establishing and maintaining parallel information collection and data management systems - particularly with regards to the continual requirement to update the systems in order to keep pace with consumers as they change insurers, discontinue renewals or change insurance policies. Additionally, this model would require regulation via a formal enforcement regime required for collection of the additional levy.

Finally, this proposed model would be disadvantageous particularly as it would not address the inherent inefficiencies of the current fire services levy model as mentioned above. This is in terms of the fact that the actual levy collected from insurers is imposed on the total premium which includes perils in addition to the proportion associated with fire.

3. What are the advantages and disadvantages of funding fire services through a property-based levy on all Victorian property and vehicle owners? Are there any factors that make a property based levy more or less practicable in Victoria compared with other states?

A broad based property levy would be most equitable and efficient. The key disadvantage of the current fire services funding regime is that it imposes a tax on people who protect their property, businesses and personal possessions by insuring them. It is their taxes that pay for the fire fighting and protection services provided to the entire community. A fairer and more rational system would see property owners pay for these services, spreading the burden equitably.

4. What are the advantages and disadvantages of all Victorian property owners contributing to one fund for the funding of both the MFB and the CFA?

The advantage of having one fund is that it would provide improved transparency to budgetary processes as well as reduced administrative costs. As noted in the *Discussion Paper* a central fund for all fire and emergency services is used in South Australia and Western Australia.

Additionally, the mechanism for collecting this tax would shift from one where several different private corporations collect the tax and then deliver it to Government for further processing and splitting between the MFB and the CFA; to one where the Government would collect and pool the taxes through one process. This would reduce the overall administrative costs associated with the current process.

Shifting away from a model where only a portion of the total population pays for the benefit for all property holders would potentially enable a higher level of funding for the MFB and the CFA as the pool of contributors would increase.

It is worthy to note, that the way in which the fire services levy contributions are currently processed, further demonstrates difficulties involved with the current regime. There is a question as to why the MFB and the CFA don't forward plan and manage their funding requirements so that the insurance industry can simply pay their contributions at the end of the financial year, once net premium has been collected.

The outcome of the current regime is that insurers are forward paying contributions, without the benefit of being able to accurately take into considerations factors that may impact premium for the actual financial year. As a result, there is a degree of budgetary uncertainty for the industry. While the industry is diligent in accurately managing this process, the administration involved in forecasting and managing quarterly contributions, along with ensuring accuracy to minimise the flow through to premiums and therefore the consumer, adds to the over all burden of the levy.

5. What are the advantages and disadvantages of introducing compulsory property insurance to address issues associated with the FSL?

While appearing to offer a simple solution to a complex problem, any compulsory scheme would present its own policy challenges. Australia's home insurance market is mature and highly competitive, with a wide choice of providers and products. An essential feature of any competitive market is the choice to "opt out" of insurance altogether. While current policy settings could do more to encourage insurance, some people will always self-insure for genuine financial, cultural or philosophical reasons. This creates a powerful incentive for the insurance industry to make its products accessible and attractive.

Indicative of a healthy and competitive market, where consumers genuinely appreciate variety, is research showing that somewhere between 36% - 50% of consumers shop around

for their insurance as opposed to paying premiums without looking for alternatives.¹ A growing number of consumers are using the internet to visit websites to research insurance policies before purchasing.²

In order to respond to this growing trend, attract customers and make insurance accessible for varying customer needs, IAG's retail brands offer a broad suite of products. Providing a great deal of flexibility and choice, products include combined home and contents, prime cover home and buildings insurance, renters insurance. Customers can choose their level of excess to reduce the amount of premium collected. Furthermore, it's easy for consumers to shop around and switch, and unlike most other financial products, contracts only run for a year with low or no exit/switching costs. This is a clear advantage of the current competitive environment.

Statutory compulsion mandates extensive regulatory intervention in pricing, distribution and service delivery. Cross-subsidies on equity or affordability grounds dampen price signals to mitigate risk. Mandated minimum cover would reduce the incentive to understand risks and take out the appropriate form of insurance, which would be a major disadvantage.

Compulsion also requires an enforcement regime. Home lenders have great difficulty ensuring compliance with the insurance obligations of their mortgagees, even though most offer insurance products and have a clear commercial interest in maximising coverage.

Furthermore, compulsion is a disadvantage as it could risk smothering the innovation that comes with the drive for difference in a highly competitive insurance market. IAG via its retail brands is continually striving to improve the way in which we respond to each event, lifting the bar each time to surpass our competitors in terms of the quality of our disaster response and during claims time. Claims time for insurers is the moment of truth, and is arguably the most significant and important point of contact we have with our customers.

For example, in the case of the Victorian Bushfires, we conducted our assessments by using aerial surveying overlaid with mapping software to fast-track claims. During the Blacktown hail storms giant crane- borne canopies were developed to allow work on roofing to continue during incessant wet weather.

6. Is non-insurance and under-insurance a problem in Victoria? Do we have accurate data on this issue?

The industry does not have accurate data on non-insurance rates in bushfire areas specifically.

The issue of non-insurance was addressed in the Insurance Council commissioned study "*The Non-insured: Who, Why and Trends*" (2007) by Dr Richard Tooth and Dr George Barker of the Centre for Law and Economics at the Australian National University. The Report found:

"Rates of non-insurance are found to be closely correlated with insurance taxes when examined over time and across jurisdictions. Following the removal of the Fire Services Levy in Western Australia (which came into effect 1 January 2004), the level of non-insurance in both building and contents (as measured from the Roy Morgan Research data) declined while rates climbed elsewhere."

¹ Source: Insurance Council of Australia Community and Stakeholder Study, UMR, November 2008

² Source: ACNielsen Australian Insurance Report 2H2006

The Roy Morgan Research data and the Australian Bureau of Statistics (ABS) Household Expenditure Survey (HES) data support the finding that states with higher tax rates on insurance premiums have higher rates of non-insurance for both building and contents insurance.” (p.4)

Details are at:

<http://www.insurancecouncil.com.au/Portals/24/Issues/The%20Non%20Insured%20-%20Report.pdf>

In 2007 the Insurance Council also published the report, “The Non Insured: Who, Why and Trends” which examined non-insurance for house and contents insurance. Details are at:

<http://www.insurancecouncil.com.au/Default.aspx?tabid=1767>

7. What reasons, if any, are there for government to ensure resident in bushfire prone areas are adequately insured? What form should government involvement take?

It is in the interest of Government to have a fully insured community so that the costs of responding to bushfire and other catastrophes are not borne by the Government and public purse. The most resilient communities are those that have a high level of preparedness and ability to recover following a crisis, or in the context of this *Discussion Paper*, following a catastrophic event such as the Victorian Bushfires. IAG believes therefore it is certainly in the Government’s interest to help foster communities that have a healthy local economy, high levels of social capital and high levels of insurance cover, access and availability.

In the absence of private insurance Governments are de facto in taking on the responsibility of insurer of “last resort” via emergency distribution of government financial assistance. Arguably, while there may be an equity argument for individuals who are financially disadvantaged to access government assistance. Open ended assistance is inequitable when provided to those individuals who are able to, but choose not to responsibly insure.

Open ended government assistance further reduces the incentive for private insurance. Clearly there is a role for governments to ensure appropriate risk management policy settings do not crowd out the private insurance market. Governments need to avoid interventions that promote dependence on government assistance and reduce incentives for self-reliance and personal responsibility. Indeed, as the Productivity Commission’s Draft Inquiry Report into Government Drought Support (2008) noted “It is also important that governments do not blur the boundaries between risk management and equity objectives” (p.165).

Insofar as governments see a need to intervene to provide financial support to non-insureds, then IAG considers that a counter-balancing policy setting, possibly using an income tax measure, is required to ensure there remains continued incentive for prudent risk management by individual to take out private insurance.

8. What effect would removing the FSL and stamp duty on premiums have on the uptake of property insurance?

The Western Australian Government replaced fire service levies with a property based funding system in 2003-04. The Sigma Plus Consulting’s *Emergency Services Levy Insurance Compliance Review: Final Report* in relation to the effect of the phase-out of the fire services levy in Western Australia indicated the removal of the levy in Western Australia contributed to state having one of the most price competitive insurance markets in Australia in 2003 and consumers responded to cheaper insurance by increasing their insurance cover to more adequately protect themselves. Details are at:

http://www.fesa.wa.gov.au/internet/upload/93510369/docs/insurance_Compliance_Rprt_April_2004.pdf

In 2007 the Insurance Council published the report, “The Non Insured: Who, Why and Trends” which examined non-insurance for house and contents insurance. The report highlighted two key aspects of non insurance - who the non-insured are, including the

characteristics of the non-insured and the effect of government policies on the extent of non-insurance. Details are at:

<http://www.insurancecouncil.com.au/Portals/24/documents/ICA%20Industry%20In%20Focus%20July%202009.pdf>

9. Are there better tools, for example web sites, ready reckoners etc that could be made available to property owners to assist them in accurately calculating the replacement cost of their property? Would availability of such tools reduce under-insurance?

The issue of underinsurance was investigated by The Australian Securities and Investments Commission (ASIC) after the 2003 Canberra bushfires resulting in increased scrutiny and a report titled "Getting home insurance right" released in 2005. Details are at [http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/underinsurance_report.pdf/\\$file/underinsurance_report.pdf](http://www.asic.gov.au/asic/pdflib.nsf/LookupByFileName/underinsurance_report.pdf/$file/underinsurance_report.pdf)

ASIC surveyed insurance companies and analysed the ways in which rebuilding costs were calculated and priced. This increased level of scrutiny and support has since helped to ensure there is a level of consistency and accuracy in the calculation of rebuilding costs. It identified the need to improve the tools to help consumers estimate rebuilding costs, encouraged community education and communication with customers at the point of renewal to increase customer understanding of the need to be adequately insured - all of which IAG was proactively doing and continues to do today.

Tools and support are readily available by IAG's retail brands (RACV, NRMA Insurance, SGIC, SGIO and CGU) for customers throughout the sales and claims process. The primary tool utilised is the Home Buildings Calculator. This data is sourced from an external supplier, Reed Business Information³ which most of the industry uses. Data is updated quarterly to keep pace with the building industry. This calculator is available either online or paper based.

IAG also recognises that many consumers feel that they grudgingly have to buy insurance as opposed to wanting to purchase it. This potentially impacts on the level of insurance cover taken out, and can mean that it is a low involvement product except at the point of claims. Historically, even after a customer makes a claim and with direct encouragement and explanation from our assessors, customers tend to be reluctant in increasing their sum insured.

As an organisation, IAG and its retail brands work proactively to educate the community on the risk of underinsurance. Across the country we run joint campaigns with our community partners to encourage the community to prepare their homes to help prevent the risk of property damage through weather events. As part of this and through a variety of campaigns and events, we encourage consumers to check their level of insurance cover and participate with our organisation in ways other than just at sales and claims time.

IAG is interested in working with Government and our customers to look at ways to reduce levels of underinsurance in the community. It is a concern to us that evidence of underinsurance prevails, and as an organisation we have made tools available and taken active steps to ensure our customers understand and keep their policies updated. While underinsurance is a complex issue, IAG believes that a fire services funding system, which encourages full value insurance would result in economic and community benefits especially with regards to underinsurance.

10. Would it be practical for insurers to rate houses in bushfire prone areas for fire safety? If so, would this affect premiums? What are the practical advantages and disadvantages of involving the CFA (or persons accredited by the CFA) in reporting a property's fire readiness for insurance purposes?

³ REED BUSINESS INFORMATION PTY LTD (A.B.N. 47 000 146 821) trading as Reed Construction Data, <http://www.reedconstructiondata.com.au/>

It is important to note that bushfire is only one of many different risks bundled into standard home insurance covers. There is no single or standard methodology for pricing this or any other risk, so in this sense it is not practical for insurers to rate houses in bushfire areas for fire safety alone. Pricing is continually adjusted based on accumulated experience and as business strategies evolve.

Each insurer will take their own view of each type of risk based on claims experience and a range of other private or public sources. Depending on the granularity of the available data and the sophistication of the insurer's systems, factors such as dwelling type and size, construction materials, building age also come into play. It is unusual for any one event, even one as large as Victoria, to have a material impact on pricing levels overall.

IAG encourages proactive fire preparedness and community education and considers this a shared responsibility between the Government, insurers and the community more broadly.

As mentioned previously, through our community partnerships, campaigns are run to facilitate community education on preparedness. Whether it is through community campaigns or in our contact with customers more generally, our objective is always to help our customers and the broader community reduce the risk of damage and the likelihood of making a claim in the first place.

Fire preparedness could potentially be considered as part of the many different factors when pricing a policy for a customer who lives in an identified bushfire area. We would be more likely to consider permanent mitigation adjustments to the property that remain static over time. Examples of these could be whether the property is connected to an external water spray system attached to the roof – with an independent power supply and that holds at least 10,000 litres, fire retardant floors, metal shutters on all windows and toughened glass windows, etc.

Accuracy of data is and would be critical to any refinement of bushfire pricing that considered mitigation activity. A body such as the CFA could make an important contribution to developing data. However the challenge would be in the ongoing resourcing of processes that not only collect the data in the first place but that are also able to keep it up to date and accurate on an ongoing basis.