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GREEN PAPER – FIRE SERVICES AND THE NON-INSURED

Insurance Australia Group (IAG) welcomes the opportunity to make a submission in relation to the *Green Paper – Fire Services and the Non-insured*.

IAG is an international general insurance group, with operations in Australia, New Zealand, the United Kingdom and Asia. Its current businesses underwrite more than \$7.8 billion of premium per annum. It employs more than 13,500 people of which around 9,300 are in Australia. IAG operates some of Australia's leading insurance brands including NRMA Insurance, CGU, SGIO, SGIC, Swann Insurance and The Buzz. IAG also distributes insurance in Victoria through the RACV brand. IAG insures approximately one in three motor vehicles, and one in four homes, in Australia.

Detailed below is a response to each of the proposed options put forward as part of the Victorian Government's review of fire services funding. Overall, IAG's preference is for Option 6, which is to replace the FSL with an "across the board" property tax. IAG believes in a fire services funding system which encourages full value insurance and that would result in economic and community benefits. A system that is fair, consistent and more understandable to taxpayers and the community at large is needed. 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 through a broad based property levy approach.

Option 1 – Retain the existing approach

The fire services levy is a poorly targeted mechanism for distributing the cost of fire services and not considered equitable.

IAG notes the Commonwealth's response to the 2009 Victorian Bushfires Royal Commission *Fire Services Levy and Insurance Discussion Paper* (December 2009) highlighted:

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“The equity of fire service levies and stamp duty on general insurance has been considered in previous reviews. Notably, in its final report to the then Commonwealth Government, the HIH Royal Commission recommended that State and Territory governments abolish stamp duty on general insurance products and that States that have not already done so abolish the fire services levies on insurers. The HIH Royal Commission found that ideally, the cost of providing fire services levies should be met by all property owners and noted that this issue was also considered by the Victorian Review of State Business Taxes in 2001. The Victorian review found that, shifting the funding for fire services away from those who currently insure their properties to all property owners, as a separate item on local government rates notices, would achieve greater equity in supporting fire services.”(p.1).

While IAG notes and supports the above findings we would reinforce that the fire services levy is a poorly targeted mechanism for distributing the cost of fire services and not considered equitable. 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.

As IAG highlighted in its submissions to various Federal and State Government taxation reviews the proportion of premium attributable to each kind of risk varies considerably from post code to post code based on local factors and claims experience. At an individual household level the premium level, and thus the levy paid, is ultimately determined by the insured value of the home and/or its contents as well as factors such as loyalty and no claim discounts. This means that areas with very low fire risk can contribute substantially more on a per household basis to total levy collections than the more bushfire prone areas of the State.

It is of note the Review of Australia’s Taxation System (Henry Review) highlighted:

“Imposing specific taxes on insurance deters people from insuring their property and encourages them to bear unnecessary risks, rather than pooling risk with others. Rates of non-insurance (for building and content insurance) generally are higher at lower incomes, yet low-income people are less able to bear the risk.”

and recommended:

“All specific taxes on insurance products, including the fire services levy, should be abolished. Insurance products should be treated like most other services consumed within Australia and be subject to only one broad-based tax on consumption.”

Similarly, The Report of the Australian Financial Centre Forum *Australia as a financial centre: Building on our strengths* (Johnson Report) recommended that all State taxes and levies on the insurance sector be removed.

A comprehensive summary of the broader impacts of FSL and other insurance taxes are attached in IAG’s submission to the Victorian Parliamentary Economic Development & Infrastructure Committee Inquiry into State Taxation & Debt.

Option 2 – Charging a levy on non-insured and under-insured property owners

The proposal would pose some challenges and would be difficult to implement practically. To begin with there are significant difficulties in identifying non – insured and under – insured properties. Furthermore, under and non insurance relates to both buildings insurance and contents insurance. Consumers vary in the type of policy and level of cover they have. They may for example choose to have contents insurance and not buildings insurance or vice versa. This would make it difficult to identify accurately across the State.

There could be a significant cost to Government in administering a system which required differentiating between Victorians who have insurance, those with lapsed insurance, those who have changed insurers, those who no longer hold insurance and those who are deceased or have moved interstate. Additionally, Victorians may hold insurance policies with any number of insurers including major insurers in Victoria and other interstate or overseas based insurers with minimal market share in that state. The establishment and maintenance of such a system would be costly, cumbersome and require a significant appeals process for Victorians who may be switching policies either between insurers or within the portfolio of their own insurance company. This option would require regulation via a formal enforcement regime required for collection of the additional levy.

This proposal would be disadvantageous particularly as it would not address the inherent inefficiencies of the current fire services levy model as mentioned in Option 1 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.

IAG believes 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.

Option 3 – Status quo plus mandating banks to issue compulsory insurance

This option would not capture all homeowners as according to ABS Census data approximately 70% of Australians own/or are purchasing their home, with the majority owning the property outright and as such they do not have a mortgage.

Moreover, there would be extensive cost in establishing and maintaining 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.

Option 4 – Introduce compulsory fire services insurance

While appearing to offer a simple solution to a complex problem, any compulsory scheme would present its own policy challenges. Compulsion requires an enforcement regime. Statutory compulsion mandates extensive regulatory intervention in pricing, distribution and service delivery.

Compulsion would also require Government to cross-subsidise those with limited ability to pay. This would have an impact on the insurance market as cross-subsidies on equity or affordability grounds would serve to dampen price signals. This can result in reduced awareness of fire risk across the community. Mandated minimum cover would reduce the incentive to understand risks and take out the appropriate form of insurance, which would be a major disadvantage. In this way, the community would potentially be less likely to take steps to reduce fire risk around their own properties.

IAG notes the Commonwealth's response to the 2009 Victorian Bushfires Royal Commission *Fire Services Levy and Insurance Discussion Paper* (December 2009):

"The Commonwealth considers compulsory insurance appropriate only in very limited circumstances. This is because compulsory insurance does not recognise that it may be a legitimate decision for some individuals to self-insure. Compulsory insurance also does not address the issue of under-insurance, and may in fact exacerbate the issue, as property owners may insure their property for less than it is worth. Mandating privately provided insurance can also result in problems if insurers are reluctant to offer products on the terms which are specific requirements at rates considered affordable."(p.5).

Option 5 – Introduce compulsory property insurance

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.

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.

¹ Source: Insurance Council of Australia Community and Stakeholder Study, UMR, November 2008 Note that this statistic would differ for commercial consumers.

² Source: ACNielsen Australian Insurance Report 2H2006

Option 6 – Replace the FSL with an “across the board” property tax (which could be risked based)

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.

IAG notes the Municipal Association of Victoria submission to the 2009 Victorian Bushfires Royal Commission *Fire Services Levy and Insurance Discussion Paper* (December 2009) which stated:

“There is considerable support amongst councils for a property-based funding model, on the basis that it would increase the number of contributors to fire services and would be difficult to avoid.”(p.15).

Again, a comprehensive summary of the arguments supporting an across the board property tax to replace the existing fire services funding model is outlined in IAG’s submission to the Victorian Parliamentary Economic Development & Infrastructure Committee Inquiry into State Taxation & Debt (attached).

Conclusion

Put at its simplest, the current fire services levy regime in Victoria 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 all Victorian property owners pay for these services, spreading the burden equitably.

If you wish to discuss this matter or make further inquiries please contact David Wellfare, Senior Adviser, Economics & Policy on (02) 9292 8593 or me on 9292 9291.

Yours sincerely,



**Michael J Wilkins
Managing Director &
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Appendix

IAG's submission to the Victorian Parliamentary Economic Development & Infrastructure Committee Inquiry into State Taxation & Debt.