AUSTRALIAN COMPETITION
& CONSUMER COMMISSION

Northern Australia Insurance Inquiry

First interim report

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Summary

Local residents and property owners across northern Australia have told us of their anxiety about the sustained, and often steep, rises in the price of their insurance. People are genuinely worried about what will happen to their family, to their community and to the development prospects of northern Australia if insurance prices continue to rise without relief. They fear devastation if disaster hits and people are no longer insured.

The concerns we heard from communities are not anecdotal or isolated. Our analysis confirms that home, contents and strata premiums are, on average, considerably higher in northern Australia than the rest of Australia and have increased more in recent years.

Over the past decade, insurers' methodologies for pricing insurance have become much more sophisticated and combined with access to better data, we have seen a shift towards more address based risk assessment and pricing. In northern Australia, insurers have also incurred some heavy losses due to high claims and increasing costs. As a result, insurance premiums are increasing, especially for those in high risk areas.

We have observed an unusual competitive dynamic, with insurers in northern Australia not necessarily motivated to compete on price for market share. Instead we have seen them increasing prices to manage their exposure in a region they perceive to be risky or volatile. This is exacerbating affordability concerns.

Consumers told us insurance is confusing, that products lack comparability, and that pricing is not transparent. This can leave consumers feeling disempowered, not unlike what we have seen in other critical markets such as energy, telecommunications and financial services.

In this first interim report to the Treasurer, we set out our findings in detail about the operation of markets for home, contents and strata insurance in northern Australia. Importantly, we also set out measures that could be taken to begin to address the problems we have identified. Many of these recommendations could also benefit consumers and insurance markets nationally if more broadly applied.

While these measures will bring improvements to insurance markets, it will still leave underlying affordability issues for some individuals that are so sharp that a stronger public policy response may be required. The key focus of our inquiry in 2019 will be to explore what further measures could be considered to improve the affordability and availability of insurance in this vitally important region of Australia.

Unusual market dynamics are leading to soft competition

The structure of insurance markets is complex. Insurers rely on both direct sales to customers and the use of intermediaries such as brokers to distribute their products.

The insurance market in northern Australia is concentrated. It is particularly concentrated in regional markets within northern Australia, some of which can be dominated by a single insurer. The eight main insurers in northern Australia currently supply home and contents insurance under 27 brands while intermediaries sell insurance products under a further 110 brands across the region. The number of brands can make it look like there are more unique suppliers than there actually are.

Our analysis suggests that in some high risk parts of northern Australia, insurers are not actively trying to win market share. Instead, they are implementing strategies to manage their exposure to customers they see as high risk. For example, they may be increasing their premiums so as to lose customers or no longer selling or renewing policies.

We found that insurers can regard price leadership in a market as exposing themselves to adverse selection (that is, attracting higher risk customers) or otherwise indicating that they have mispriced risks compared to a competitor. These unusual market dynamics soften the competitive pressure on other insurers in these areas.

Barriers to entry into northern Australian insurance markets are likely to be significant for insurers not already established in other parts of Australia. But they appear lower for insurers already active in Australia but not currently active in the region.

The large number of insurance products, with subtle distinguishing differences, leads to a degree of customer inertia and a reliance on familiar brands that can result in those consumers paying higher premiums at renewal compared to those who shop around for the best deal and switch suppliers.

Insurer profitability in northern Australia is improving but still poor compared to other areas

Heavy losses, and high and rising costs, have played a big part in rising premiums in northern Australia.

Insurers incurred heavy losses in northern Australia earlier this decade due to the impact of significant natural disasters which resulted in large claim amounts, including Cyclone Yasi (2011) and the 2010–11 Queensland floods. Insurers' financial performance in northern Australia has significantly improved in recent years, but remains poor. While some insurers have been profitable, their margins have been lower than in the rest of Australia. Other insurers have continued to operate at a loss over recent years, albeit a smaller one.

While premium revenue is proportionally much higher in northern Australia, so too are insurers' costs. Costs have risen over the last decade at a greater rate than costs in the rest of Australia. Claims are more frequent, and on average larger, in northern Australia (particularly for strata insurance). This has also impacted on the cost of reinsurance, which is a significant cost component for insurers.

Consistent with rising premiums, we also observed that insurers' commission costs in northern Australia have more than doubled on a per policy basis since 2007–08.

The prices for home, contents and strata insurance are much higher in northern Australia

Home and contents insurance has become significantly more expensive for consumers over the last decade. Combined home and contents premiums rose by 130 per cent in real terms in northern Australia between 2007–08 and 2017–18, compared to 50 per cent in the rest of Australia.

In 2017–18, we found combined home and contents insurance products in the north of Western Australia have the highest average annual premiums ($3500), followed by north Queensland ($2400) and the Northern Territory ($2200). The average in the rest of Australia is $1300, just half the northern Australia average.

Many local residents and property owners in northern Australia face home and contents premiums that are much higher than these averages. Consumers in the Pilbara and coastal north Queensland pay the highest premiums on average. Consumers in these regions can face premiums of more than $4000 for a combined home and contents product.

Strata insurance, which is required under state and territory legislation, is also more expensive in northern Australia. We found the ratio of premiums to sum insured can be up to four times higher than in the rest of Australia.

Insurance premiums are driven by more than an individual property's risk

Throughout our consultation, we heard local residents and property owners express concern that insurers were using high premiums in their region to subsidise disasters in another region. We have not found evidence to suggest this was the case.

The high risk in northern Australia, and high costs of serving the area, are contributing to high and increasing premiums in the area. However, insurers' use of premium adjustments, to manage their concentration risk and exposure in northern Australia, appears to be exacerbating affordability issues. Insurers typically set insurance premiums in a three stage process. Each stage is adding to the high premiums observed in northern Australia.

Insurers first set a technical premium which reflects their estimate of the cost of providing insurance to an individual property. We have not seen evidence to suggest that insurers are taking an unreasonable approach to setting technical premiums in northern Australia. Instead, we have seen insurers invest in developing more sophisticated models which, combined with better access to data, is allowing them to make more accurate assessments of catastrophe risk.

More granular pricing approaches, in particular address based risk assessment, has been a key contributor to increased premiums for many consumers. As community rating approaches have been wound back, high risk consumers have experienced significant premium growth. The introduction of flood cover, which insurers often make compulsory, has also seen premiums rise for consumers in high flood risk areas.

Insurers then adjust their technical premium, taking into account factors including their risk appetite and competitive positioning, particularly in higher risk areas. In northern Australia, we have seen this result in premiums that can be considerably higher than the technical premium. This reflects an unusual dynamic where insurers are not using price to compete for market share in high risk areas. Rather they are using price to shed the number of customers they have (and/or deter new customers) in a particular area or who they assess to be higher risk.

For the insurer, this will allow them to reduce their exposure to the losses they would face should a catastrophe affect the area. Such adjustments can drive affected customers to other insurers as they search for a better price, increasing the likelihood of those insurers making similar adjustments. This dynamic can lead to insurers offering premiums in high risk areas that are far higher than technical premiums. This is more likely to occur in areas with fewer active insurers.

The third pricing factor which is contributing to higher premiums in northern Australia is stamp duty levied by states and territories, and also the GST, both levied as a percentage of insurance premiums. As premiums grow in northern Australia, so too does the dollar value of stamp duty (which is levied on the GST-inclusive premium amount). In real terms, the stamp duty revenue collected from home, contents and strata insurance in northern Australia has increased from $22 million per year in 2007–08 to $79 million in 2017–18. GST revenue has increased from $25 million to $78 million over the same period.

Conflicts of interest are common and significant

Insurance brokers can serve an important role in helping consumers to assess and understand their risk, source quotes and manage any claims. However their remuneration structures inevitably give rise to conflicts of interest, which consumers may not be fully aware of.

Despite an insurance broker owing a duty of care to the insured, most brokers are remunerated by insurers, and their remuneration is typically calculated as a percentage of the premium, or some other volume-based remuneration. There is little or no direct relationship between the size of the commission and the work undertaken.

We found commission rates of 15 to 20 per cent per year of the base premium to be common. Remuneration rates inclusive of all incentive payments can reach around 30 per cent of the cost of the premium.

Strata managers were criticised heavily throughout our consultation. Strata property owners accused them of having no incentive to negotiate the best premium, again due to conflicted remuneration arrangements where they receive a share of insurance brokers' commissions, which are based on a percentage of the premium.

Product variability can make comparisons difficult for consumers

We are not satisfied that the current disclosure framework reasonably allows consumers to identify how seemingly comparable policies differ.

The standard cover regime exists to standardise terms and conditions of insurance contracts and protect against a lack of coverage for events that a consumer might commonly expect to be covered by their product. Insurers' freedom to derogate from standard cover should, in theory, allow insurers to offer the variety of products that consumers demand. But this fundamentally relies on consumers being able to confidently identify the policies available that most closely offer what they want.

In spite of all the definitions, inclusions, exclusions, and limits often buried deep in the fine print of disclosure documents, the insurance industry continues to advocate for consumers to choose an insurance policy based on an understanding of features, not just on price. However current practices make meaningful comparisons very difficult. The challenges in comparing policies is exacerbated by the proliferation of different definitions used by insurers of the same key terms.

Consumers currently lack standard home insurance and contents insurance products to compare across insurers or use as an anchor point when considering products with different features.

Consumers are not always given the information they need to make good choices

In any industry, confident and engaged consumers are a fundamental driver of competition. The complexity and opacity of home, contents and strata insurance is challenging this outcome in northern Australia. We join with a number of reviews before ours to make recommendations aimed at improving the effectiveness and relevance of information provided to consumers.

Consumers expressed frustration at the lack of transparency in how insurers assess risks and calculate premiums, particularly when premiums are increasing steeply. Insurers can, and should, do more to explain how they are assessing risks, how they are setting premiums and why prices are increasing. Consumers wanted an opportunity to challenge what an insurer was telling them.

Higher premiums have added to the cost of living for residents of northern Australia and have prompted many consumers to reduce their level of coverage through higher excesses or lower sums insured. Some told us that, as a last resort, they have had to choose to not be insured.

More granular data, and increasingly sophisticated analysis of that data, is allowing insurers to identify and understand risks more clearly. This offers significant benefits through improved risk identification, product innovation, and mitigation opportunities, but it also raises new concerns with issues of data access, sharing, and privacy. It also raises concerns about asymmetry of information—when insurers know much more than consumers.

Many consumers did not have positive claims experiences and they want more say over how their claim is settled

People told us about lengthy delays in claims settlement, excessive repair quotes and numerous cases of unsatisfactory work. It was clear to us that this exacerbated the distress and trauma these residents were already experiencing as a result of their losses. Some stakeholders also raised concerns that consumers were often unaware that loss adjusters were not independent but acted on behalf of insurers.

There are a range of circumstances where a consumer may prefer a cash settlement of a home insurance claim, rather than repair or rebuilding work being undertaken by an insurer. Submissions highlighted a range of potential problems that can arise when insurers have the discretion to cash-settle claims against the wishes of a consumer, or where the consumer does not have a clear understanding of the implications of this decision.

Mitigation can improve affordability, but uncertainty about premium reductions can deter household investment

Mitigation of natural hazard risk remains an important part of any strategy to reduce insurance premiums. Governments, industry, communities and individuals can all contribute to mitigation.

Some insurers offer explicit premium discounts to policy holders who undertake mitigation initiatives at a household level. While these explicit discounts can be substantial for a small number of consumers, we found they are relatively modest for most, particularly when compared to increases in base premiums over time. We also found this lack of transparency about the size or longevity of premium reductions, coupled with high upfront costs, can discourage consumers from improving the resilience of their property.

Mitigation initiatives at a community level (such as flood levees) can significantly reduce risks (and premiums) for many residents within a local area. Insurers have a central role to play in working with governments to identify measures and/or locations that would reduce risk and the premium reductions they would expect to result.

Stronger Australian building standards have proven to be one of the most effective mechanisms for improving resilience. Properties built to modern building standards, which set minimum acceptable standards, are generally at less risk of sustaining costly structural damage. However, there appears to be scope for further enhancements to building standards to better protect properties from natural hazards and further assist with the long term affordability of insurance.

There are also opportunities for governments (including local councils), insurers and developers to work together to avoid new developments in higher risk areas, thereby reducing the potential for unacceptably high insurance premiums in the future.

Where to next for our inquiry

Our inquiry will continue through 2019 and conclude at the end of 2020.

This report sets out a range of measures we consider will improve how insurance markets work and achieve better outcomes for consumers. We urge governments and industry to take quick action on our 15 ***recommendations***. Some of them have been made a number of times before.

We have also made 13 ***draft recommendations*** that we believe have the potential to make markets work more efficiently. We welcome stakeholder feedback on these proposals.

While we believe these measures will bring improvements to insurance markets, we consider a stronger policy response may be necessary to address the scale of insurance affordability concerns that are emerging.

We have identified five ***focus areas*** for the next stage of our inquiry. We will use 2019 to explore these areas in a level of detail that has not been possible to date.

In particular, we will broaden the focus of our inquiry in 2019 to look at how issues of insurance affordability and availability have been considered and addressed around Australia and/or internationally, and in relation to other forms of insurance. We will consider proposing further policy measures that could have the potential to achieve real and meaningful change for northern Australian communities.

These recommendations, draft recommendations and focus areas are set out below. More details on these focus areas, as well as specific consultation questions on the draft recommendations, are set out in chapter 13. We encourage industry, consumer and regional stakeholders, and local communities across northern Australia to continue to engage with us.

Our inquiry will continue to concentrate on northern Australia, however many of the issues we have identified are common to insurance markets nationally, or are likely to be present in other parts of the country that are subject to a heightened risk of natural catastrophes, are remote or otherwise facing affordability and availability concerns. As such, some of the recommendations and draft recommendations we make in this report are also likely to have merit in the rest of Australia.

Focus areas for 2019

Focus area 1: Measures to further improve insurance affordability and availability

We will review options considered in Australia and internationally to improve insurance affordability and availability, and whether these could be applied in northern Australia.

This will enable us to present a broader range of options for governments to consider which have the potential to make a sustainable and meaningful impact on the affordability and/or availability of insurance at an acceptable cost.

Focus area 2: Detailed case studies on sub-regions in northern Australia

We will undertake a number of detailed case studies on parts of northern Australia that face particularly acute availability or affordability issues.

In addition to looking more closely at premium pricing in the area, we will also consider other issues such as claims experience, levels of non-insurance and under insurance, and the degree of competition in the area.

Focus area 3: Examination of premium adjustments

We will further examine the use of premium adjustments by insurers operating in northern Australia. In particular, we will consider:

- **the scale of premium adjustments and their potential to distort price signals to consumers regarding risks**
- **the potential impact of adjustments employed to manage concentration risk and exposure, on higher risk consumers**
- **the extent to which insurers are discriminating between new and existing customers through premium adjustments.**

This will help us to determine the extent to which premiums could be lower in northern Australia, and to consider whether there are ways in which the impact of these adjustments on higher risk consumers could be lessened.

Focus area 4: Identify and investigate barriers to expansion (or re-entry)

We will engage with Australian insurers not currently active in northern Australia to identify and investigate barriers to their expansion (or re-entry) into northern Australian markets.

We consider that for those insurers already operating elsewhere in Australia, barriers to expanding into northern Australia are significantly lower than the barriers for a new entrant to the Australian insurance market. However, some established insurers generally do not write new business in northern Australia.

We will continue to explore, in consultation with insurers, the regulatory and other barriers to expansion into northern Australia. We will also engage on this issue with insurers active in only some regions of northern Australia.

Focus area 5: Understanding non-insurance and how it may be addressed

We will explore the extent and reasons for non-insurance throughout northern Australia, including in indigenous communities. As part of this focus area, we will consider current and potential measures to improve the accessibility of insurance to low income households. We will look at the extent to which insurers make Centrepay available to eligible customers and why hardship policies are generally limited to the payment of an excess and not a premium.

This will help us provide a more complete assessment of the accessibility and performance of insurance markets in northern Australia and help guide any other policy responses. Insurance is a 'near essential' product. There are currently very limited obligations on insurers to improve its accessibility to all members of the community and evidence of innovation is lagging other industries. Industry hardship programs are less sophisticated and more limited in accessibility than other industries.

Recommendations

Recommendation 1: Abolish stamp duty on home, contents and strata insurance products

The governments of Western Australia, the Northern Territory and Queensland abolish stamp duties on home, contents and strata insurance products. State and territory revenue needs could be more equitably met through other means.

It has been widely acknowledged that stamp duties on insurance contracts are an inefficient form of taxation. This recommendation is in line with recommendations from previous inquiries into insurance and taxation issues.

Recommendation 2: Re-base stamp duty, use stamp duty revenue and mitigation

If stamp duties on insurance are maintained, the Western Australia, the Northern Territory and Queensland governments should reduce their burden on consumers in higher risk areas by levying stamp duties for home, contents and strata insurance with reference to the sum insured value, rather than the premium level.

In any case, they should also direct a portion of revenue from stamp duties on insurance products towards measures to improve affordability for low income consumers or to fund mitigation works.

Re-basing stamp duty to be levied on sums insured will make it fairer to consumers living in higher risk areas.

Governments have previously received and continue to enjoy a windfall gain from the growth of insurance premiums in northern Australia. Directing revenue from stamp duties to public mitigation works should only be considered where insurers have provided estimates of premium reductions that would result from such works, and commit to reporting against these where work is undertaken (see recommendation 14).

Recommendation 3: Insurers to report their brands and where they are writing new business

The Insurance Contracts Act should be amended to require insurers to report regularly to ASIC on the brands that they underwrite, and in which postcodes new business has been written for home, contents and strata insurance products.

This will provide greater transparency on which insurers underwrite which brands and assist consumers searching for alternative suppliers in their area. This would build on the Productivity Commission's recommendation in the recent inquiry into competition in the Australian financial system that insurers should provide an up-to-date list of the brands they underwrite to ASIC and that ASIC should transparently publish this information as a list on its website. (PC recommendation 14.2)

Recommendation 4: Standardise definitions of prescribed events

The Treasury's review of the standard cover regime should develop a proposal to standardise the definitions of prescribed events (including 'action of the sea', 'impacts' and 'storm') to enable greater certainty for consumers and comparability of products.

New standard definitions should be drafted in a way that removes potential gaps in coverage between prescribed events, avoids the introduction of ambiguous concepts, and does not unnecessarily limit insurers' scope for future beneficial product innovation.

Recommendation 5: Review and mandate standard cover

The Treasury's review of the standard cover regime should develop a proposal to mandate that insurers offering home insurance/contents insurance products should also offer a home insurance/contents insurance product that does not deviate (through inclusions/exclusions) from the revised standard cover terms in the Insurance Contracts Regulations.

By ensuring there is one common product from each insurer (but not necessarily each brand), consumers could easily benchmark insurers against each other. This should not limit an insurer from offering other products that provide cover that differs from the standard cover product but insurers should be required to clearly indicate how these products differ from their standard cover product.

Recommendation 6: Unfair contract term protections should apply to insurance

The unfair contract term protections in the Australian Securities and Investments Commission Act should apply to insurance contracts regulated by the Insurance Contracts Act.

The government is currently consulting on this change (which it has agreed to in principle).

Recommendation 7: A link to MoneySmart should be on new quotes and renewal notices

The Insurance Contracts Regulations should be amended to require insurers to clearly inform consumers about the Australian Government's MoneySmart website (www.moneysmart.gov.au). A link to MoneySmart using uniform text should be provided on new quotes and renewal notices.

MoneySmart includes information to help consumers understand insurance. This is an important opportunity to raise awareness of the usefulness of this website.

Recommendation 8: Better understand information that falls within 'general financial advice'

The Insurance Council of Australia should engage with ASIC to gain a clearer understanding about the nature and type of information insurers can give to consumers within the meaning of providing general financial advice.

This would ensure that insurers are not refraining from providing general information, for example about rebuilding costs and building valuations, which would assist a consumer make an informed decision about their own situation.

Recommendation 9: Disclose costs that count towards 'sum insured'

The Insurance Contracts Regulations should be amended to require that insurers clearly disclose the types of costs that will count towards the sum insured amount for buildings (such as the costs of demolition, debris removal or for professional fees) where these are not provided for through a separate allowance under the policy. This information should be provided on any sum insured calculators used by the insurer and alongside the sum insured figure.

This will help consumers understand why and how calculator estimations can differ and empower them to make more informed decisions about their nominated sum insured. It should be provided alongside the sum insured amount for a property, including in quotes for new policies, renewals and on certificates of insurance.

Recommendation 10: Disclose the premium, sum insured and excess on a renewal notice

The Insurance Contracts Regulations should be amended to require that renewal notices for home, contents and strata insurance clearly disclose the premium, the sum insured and any excess of the expiring policy. Insurers should also provide this information upon request.

This will allow consumers to easily identify how the insurer proposes to vary these terms from the previous year and seek explanation of any changes.

Recommendation 11: Extend the ban on conflicted remuneration to insurance brokers

The Corporations Regulations should be amended to remove the exemption for general insurance retail products from the conflicted remuneration provisions as they apply to insurance brokers.

Commissions and other benefits given to insurance brokers can give rise to an unacceptable conflict of interest. As is already the case for other financial products, insurance brokers should be prohibited from receiving commissions and other benefits where these create a conflict with a broker's obligation to act in the best interest of their clients. Disclosure alone is insufficient to address these conflicts.

Recommendation 12: Better information for consumers lodging a claim

The General Insurance Code of Practice should be amended to require that at the time a consumer lodges a claim, an insurer or its agent must clearly inform the consumer of the insurer's claim handling policy, and expressly refer to:

- **how the insurer will assess the validity of the consumer's claim**
- **the insurer's preferred repairer policy and in what circumstances a consumer can use their preferred repairer**
- **how decisions are made on cash settlements**
- **who will be managing the claim (for example, the name and contact details of a contracted claims company if relevant)**
- **the fact that the loss adjuster is acting on behalf of the insurer and not the consumer**
- **the consumer's right to make a complaint to the insurer and the Australian Financial Complaints Authority.**

Recommendation 13: ASIC approval for the General Insurance Code of Practice

The Insurance Council of Australia (ICA) work with ASIC to obtain its approval for the General Insurance Code of Practice.

The ICA has indicated in its recent Code of Practice Final Review Report that in order to meet the requirements for ASIC approval it will make a number of changes to the Code. The ICA should work with ASIC to ensure that these changes are sufficient to meet at least the minimum standards in Regulatory Guide 183 to obtain ASIC approval.

Recommendation 14: Public mitigation works and expected premium reductions

The insurance industry should work with governments to identify specific public mitigation works (e.g. flood levees) that could be undertaken and insurers should provide estimates of the premium reductions they anticipate should the works proceed.

Actual premium reductions following such works should also be publicly reported by insurers, measured against their estimates.

Recommendation 15: Building code changes to better protect interiors and contents

The Australian Building Codes Board expressly consider measures that better protect the interiors and contents of residential buildings from damage caused by natural hazard risk (such as, wind-driven water ingress around doors and windows during and following storms).

When assessing the costs and benefits of potential code amendments, the ABCB should also consider the potential longer term impacts on insurance premiums.

Draft recommendations

Draft recommendation 1: Insurers should estimate a sum insured for customers

The Insurance Contracts Regulations should be amended to require insurers to estimate an updated sum insured for their home insurance customers and advise them of this estimate on their renewal notice.

This estimate should note when the information used by the insurer to form the estimate was last updated by the consumer, and direct the consumer to contact the insurer if renovations/alterations to their home had occurred since then. Where the sum insured estimate is materially higher than provided for under the policy, the renewal notice should also include a warning to the customer about the dangers of their property being underinsured.

Draft recommendation 2: Prominently publish PDSs and KFSs online with product offerings

The Insurance Contracts Regulations should be amended to require insurers to publish key facts sheets and product disclosure statements online in a prominent manner and alongside the relevant products.

They should be accessible prior to the commencement of a quoting process. This will facilitate more timely and convenient access for consumers to important information about products they are interested in buying.

Draft recommendation 3: Disclose premium impacts of optional inclusions or exclusions

The Insurance Contracts Regulations should be amended to require that insurers disclose the premium costs or saving for each optional inclusion or exclusion they offer to a consumer. Insurers should also indicate the premium cost or saving associated with incremental changes in excess levels and sums insured. This information should be provided to a consumer with a quote for a policy and upon its renewal.

Providing consumers with information about the cost impact of optional inclusions/exclusions (e.g. flood cover, accidental breakage cover) as well as variable costs (such as changing an excess or sums insured) will allow consumers to make more informed decisions about their choice of cover.

Draft recommendation 4: National home insurance comparison website

The government should consider developing a national home insurance comparison website. It should require the participation of all insurers active in relevant markets, allow consumers to compare policies by features, and make it quick and easy for consumers to act on the results.

An independent insurance comparison website may facilitate more informed consumer choice by assisting consumers to quickly and easily find insurers in their area and offering policies that meet their needs. Comparison websites can provide an opportunity for new entrants to increase consumer awareness of their brand at relatively low cost, reducing a barrier to entry. Enhanced comparability of products, such as through standardised definitions (recommendation 4) and mandated standard cover (recommendation 5), will assist in the effectiveness of such a website.

Draft recommendation 5: Renewal notices should give 28 days notice

The Insurance Contracts Act should be amended to require insurers to provide renewal notices for home, contents and strata insurance no less than 28 days before the expiration of their insurance coverage.

The Insurance Contracts Act currently requires no less than 14 days. The current minimum timeframe does not provide consumers with sufficient time to consider their renewal quote and explore their insurance options. It also may not be sufficient time for some consumers to have ready-access to funds.

Draft recommendation 6: Disclosure where premium increases are capped

The Insurance Contracts Act should be amended to require insurers that have capped premium increases for particular risks (to slow the rate of adjustment to a higher technical price or other pricing objective), to disclose this to an affected policy holder and provide an estimate of the timing and extent of premium increases that the insurer intends to apply in future.

This will allow consumers to recognise price as a signal of risk and prepare for potential future premium rises.

Draft recommendation 7: Consider likely insurance costs before purchasing real estate

States and territories should implement measures to prompt consumers to investigate insurance costs when they are considering purchasing real estate.

As a first step, states and territories should include a statement in a statutory information disclosure for a real estate transaction advising any potential purchaser to obtain an insurance estimate as part of their due diligence.

If recommendation 5 (to review and mandate standard cover) is accepted, states and territories should mandate that a current home (building) insurance premium based on the standard cover product be listed in a statutory information disclosure for a real estate transaction.

This will provide prospective purchasers with a clearer expectation of the possible insurance costs associated with the property.

Draft recommendation 8: Requesting personal information held by insurers

The Insurance Contracts Regulations should be amended to require insurers to provide clear notice to consumers that they can obtain a copy of the information that the insurer holds about them, and contact details for doing so. This notice should be provided on a certificate of insurance and any renewal notices.

This will empower consumers to check and confirm their risk assessment, pricing and claims assessment is based upon reliable and verifiable information.

Draft recommendation 9: Strata managers to be remunerated by body corporate only

State and territory legislation governing strata managers should be amended to prohibit strata managers from accepting payments in relation to arranging strata insurance other than those agreed to, and made by, their body corporate.

Strata managers should be required to negotiate any fees or payments for arranging insurance directly with the body corporate they are servicing. This would encourage remuneration arrangements that better align the interests of the strata manager and their clients.

Draft recommendation 10: Clear disclosure of products considered and remuneration

The Corporations Regulations should be amended to require comparison websites and insurance brokers to disclose a complete list of what home, contents, or strata insurance products they will consider when making a comparison or providing a recommendation to a consumer. If recommendation 3 (insurers to report their brands and where they are writing new business) is adopted, this disclosure should also refer consumers to this information. Finally, comparison websites should also be required to disclose the amount of commission and other remuneration that they receive for each product.

Comparison websites and insurance brokers only consider a sub-set of the market when providing a quotation or recommendations. Consumers should clearly understand the breadth of search undertaken by the comparison website or insurance broker they are looking to use.

Draft recommendation 11: Giving consumers more control over how claims are settled

The Insurance Contracts Act should be amended to provide consumers with the right to choose whether their home insurance claim is settled through a cash settlement or by proceeding with a repair/rebuild managed by the insurer.

The consumer must be given clear notice of the implications of accepting a cash settlement, for example the insurer will be discharged of any obligations to manage or guarantee the quality, cost or timeliness of any repair the consumer chooses to undertake. Any ancillary expenses subject to the claim that are not within the scope of works for the quote (such as temporary accommodation costs) would be settled separately.

Draft recommendation 12: Clearly stated mitigation discounts

The Insurance Contracts Regulations should be amended to require insurer quotes and renewal notices for a property to expressly show what discounts have been applied (if any) to reflect mitigation measures undertaken on that property.

This is important to help ensure premium adjustments are comparable between insurers and transparent for consumers. It also provides clarity to consumers and assists with evaluating investments in mitigation works.

Draft recommendation 13: Information on mitigation works that could reduce premiums

The Insurance Contracts Regulations should be amended to require insurer quotes and renewal notices for home insurance to provide a schedule of mitigation measures which customers of the insurer have undertaken for properties with similar characteristics in order to improve their risk rating. This should include a guide to the premium reductions (in percentage terms) that consumers have received for undertaking these measures.

This would provide (new or renewing) consumers with current information on a practical range of actions that could be undertaken to mitigate risk and show them what the benefit could be in terms of premium reductions. This will assist consumers to decide if the risk mitigation option is worth the upfront cost.

1. Setting the scene

Insuring a home in the north of Australia can be expensive. Over the past decade, prices have trended upwards at an unprecedented rate. Some local residents and property owners are now facing annual premiums of many thousands of dollars, intensifying concerns about affordability of insurance for ordinary Australian households. Concerns have also risen about the availability of insurance, with some communities worried about the level of choice available in their area.

The prevalence of extreme weather events and their level of destructiveness is not a rare occurrence in some northern Australian communities. The threat of seasonal storms, cyclonic activity and bushfires characterise daily living. The land is expansive, the population clusters often sparse and local economies smaller, all of which can add to the cost of goods and services.

Insurance is an investment in protection from financial devastation if property we cannot easily afford to replace is lost or significantly damaged. Insurance is widely described as a near-essential service by many property owners, and indeed for strata property owners in Australian states and territories, it is mandatory.

Northern Australia covers an area of approximately three million square kilometres and is home to around five per cent of Australia's population. A strong and prosperous north is crucial to Australia's economic future. The Australian Government's 2015 white paper on developing northern Australia, *Our North, Our Future*, sets out 51 commitments over 20 years to support the north to achieve its potential.

For small communities, towns and regional cities in northern Australia that are striving to grow and flourish, the affordability of insurance is increasingly recognised as a challenge to liveability and consequently economic prosperity more broadly. The cost of insurance in the north is not just a problem for the north; rather for the whole Australian community that draws on the strength of the economies of the northern regions and has a strong interest in their ongoing development.

Charities and governments in Australia also provide significant amounts of assistance to households and communities who have been adversely affected by natural disasters. High rates of private insurance are socially beneficial, not only in terms of the efficiencies of risk pooling, but also in reducing the reliance on governments (taxpayers) and charities to support the personal hardship that arises when uninsured property is damaged or lost in disaster situations.

The affordability and availability of home, contents and strata insurance is a concern that is relevant to all of us.

Our terms of reference

On 25 May 2017, the Treasurer directed the Australian Competition and Consumer Commission (ACCC) to hold an inquiry into the supply of residential building (home), contents and strata insurance products to consumers in northern Australia.

Matters to be considered by the inquiry shall include, but not be restricted to:

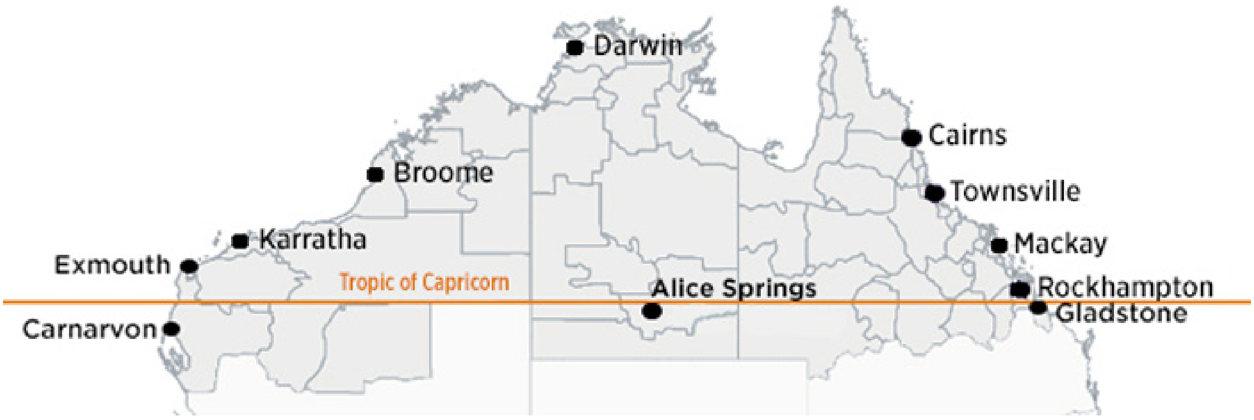
- pricing and availability of insurance to consumers in northern Australia
- key cost components of insurance pricing in northern Australia and how they have changed over time, particularly catastrophe risk
- terms and conditions on which insurance is supplied
- competitiveness of markets for insurance in northern Australia
- existence and extent of any barriers to entry, expansion and/or exit in the supply of insurance in northern Australia
- any impediments to consumer choice, including transaction costs, a lack of transparent information, or other factors

- identifying any regulatory issues, or market participant behaviour or practices that may not be supporting the development of competitive markets for insurance in northern Australia
- the profitability of insurers through time and the extent to which profits are, or are expected to be commensurate with risk.

The notice from the Treasurer asking the ACCC to undertake the inquiry is at Appendix A.

For the purposes of this inquiry, northern Australia broadly corresponds with the whole of the Northern Territory, those parts of Western Australia and Queensland that are north of the Tropic of Capricorn and some areas just south of the tropic, including Carnarvon and Gladstone.[1] A map is at figure 1.1.

Figure 1.1: Map of northern Australia



While the terms of reference focus our inquiry on northern Australia, given the nature of the insurance industry, it is inevitable that many issues that we are considering exist throughout Australia more generally. This is especially the case with other parts of the country that are experiencing affordability and/or availability concerns due to the risk of significant weather events, catastrophes or geographic remoteness. Matters relating to how consumers identify, compare and choose insurance products, for example, are also broadly relevant to consumers throughout the country. It also follows that many of the measures we propose in this report could apply nationally.

In this inquiry, we are considering the supply of home, contents and strata insurance products:

- **Home insurance** provides cover for the insured building(s) only. Also referred to as 'building insurance', this will often be purchased by landlords (often as part of a landlord insurance policy which can include features like rental protection), and by people who have chosen to buy home and contents insurance from different insurers or brands.
- **Contents insurance** provides cover for contents only, and will often be purchased by renters and by people who have chosen to buy home and contents insurance separately from different insurers or brands.
- **Strata insurance** is typically required by state and territory legislation to cover the estimated total cost of replacing the common property of a strata scheme.

We will refer to home, contents and strata insurance specifically where relevant. References to 'insurance' should be taken as a reference to all three.

1 More formally, Northern Australia has the meaning given in s. 5 of the *Northern Australia Infrastructure Facility Act 2016*.

Our approach to this inquiry

A number of recent inquiries, reviews and research have considered issues related to affordability and/or availability of insurance in northern Queensland specifically and northern Australia generally. For example the work of the Productivity Commission, of the Northern Australia Insurance Premium Taskforce, and the Senate Inquiry into Australia's general insurance industry. We acknowledge the important contribution offered by previous reports to exploring concerns, identifying issues, and proposing policy responses. We also acknowledge the current *Royal Commission into misconduct in banking and financial services*.

Our inquiry builds on previous studies, but is fundamentally different for two key reasons:

- First, we have used our powers under the *Competition and Consumer Act 2010 (Cth)* to obtain a significant volume of detailed information from insurers that past reviews have not been able to access.
- Secondly, our inquiry is focusing closely on competition, regulation and consumer protection. We are applying our expertise in these fields to examine the structure of the industry and how insurance markets are operating.

There is a broad range of stakeholders with a strong interest in our inquiry including local residents and property owners across northern Australia, the insurance industry, regulators, governments, local councils, regional development organisations, brokers, strata management groups and consumer advocacy groups. Our public consultation allowed us to hear directly from these stakeholders.

In October 2017, we released an issues paper for consultation. We received over 280 submissions during a 16 week period, a high proportion of which came from local residents and property owners across northern Australia. Over 150 people attended our public forums in Townsville, Cairns, Rockhampton, Mackay, Broome, Karratha, Darwin and Alice Springs between 15 November and 6 December 2017 and shared their views and experiences with us directly. The issues paper, submissions and a summary of each public forum are published on our website.[2]

We have obtained detailed information from eight insurers[3] using our compulsory information gathering powers. These powers are available to the ACCC under section 95ZK of the CCA. This has allowed us to gain unique insight into the home, contents and strata insurance markets by obtaining information that past reviews of insurance markets have not been able to access. The insurers are:

- AAI Limited (Suncorp)
- Allianz Australia Insurance Limited (Allianz)[4]
- Commonwealth Insurance Limited (CommInsure)
- Insurance Australia Limited (IAG)[5]
- QBE Insurance (Australia) Limited (QBE)
- RACQ Insurance Limited (RACQ)
- Westpac General Insurance Limited (Westpac)
- Youi Pty Ltd (Youi).

2 www.accc.gov.au/insurance.

3 We have also received more limited information from a number of other insurers with limited or not a current presence in northern Australia.

4 The Territory Insurance Office (TIO) brand dominates in the Northern Territory. Allianz acquired the TIO's business from the Northern Territory Government in 2015. We have been able to obtain only very limited data about the TIO's business prior to this acquisition. As such, reported policy numbers, claims and premiums for the Northern Territory prior to 2015 are less certain.

5 IAG is the non-operating holding company (NOHC) of Insurance Australia Limited (IAL). We refer to IAL as IAG throughout this report.

We have received and analysed an extensive volume of documents and financial data from the insurers. The documents we required are wide-ranging and provide detailed information about the operation of insurers' businesses, including:

- how prices are set and the cost components of premiums
- how premiums, excess levels, sums insured, claims expenses and number of policies in northern Australia compare to other parts of Australia
- the contractual arrangements that may be used between insurers and related bodies corporate, insurance intermediaries, reinsurers and repair and or replacement providers
- insurers' financial performance since 2007–08.

We also obtained around six million data points from insurers providing aggregated information on their policies, premiums and claims.

About this report

This is the first of three reports that we are required to provide to the Treasurer. Our second interim report will be provided by 30 November 2019 with a final report due at the conclusion of the inquiry by 30 November 2020.

In addition to these requirements, in June 2018, we provided a short update report to the Treasurer and published it on our website for interested stakeholders.[6] That report contains preliminary observations about northern Australian home, contents and strata insurance markets drawn from our public consultation and information gathered from insurers.

In this report, we set out our findings in detail about the prices, costs and profits in the home, contents and strata insurance markets in northern Australia. We also set out a range of measures with the potential to improve the operation of insurance markets.

There are measures in this report that we propose be taken by industry and/or governments, without delay. We refer to these as recommendations. We have made **15 recommendations** in this report.

We have also identified measures with the potential to improve the function of insurance markets. We refer to these measures as draft recommendations. We are seeking stakeholder views on the **13 *draft recommendations*** in this report.

We have also identified **5 focus areas** for the next stage of our inquiry. We will also use 2019 to explore these areas in a level of detail that has not been possible to date.

We will continue to monitor insurance markets in northern Australia as our inquiry progresses. This report covers the period up to and including the 2017–18 financial year. Our next interim report to Treasurer due in November 2019 will cover the prices, costs and profits in northern Australian insurance markets for 2018–19.

Structure of this report

There is a very large volume of diverse information to consider and report on. At times, there is some overlap between chapters. This has allowed us to consider complementary information in different contexts and we have cross-referenced to indicate this.

Chapter 2—Market structure: provides an overview of the structure of insurance markets in Australia and across northern Australia, including the types of insurance products available, the size of various insurance markets in northern Australia and how insurance is supplied to consumers.

Chapter 3—Insurance prices in northern Australia: sets out in detail the trends and levels of retail premiums since 2007 with a more detailed examination of premiums for the 2017–18 year. Premiums

6 www.accc.gov.au/focus-areas/inquiries/northern-australia-insurance-inquiry/update-report.

are broken down by product and region and compared across northern Australia and to the rest of Australia.

Chapter 4—The cost of providing insurance: sets out the main costs of supplying insurance across Australia, including claims costs, and how these have changed over time. It considers the impact of natural catastrophes on claims and reinsurance expenses in northern Australia.

Chapter 5—How insurers set premiums: discusses insurers' approaches to setting premiums. It looks at the different components of premiums and how pricing methodologies have developed. It also considers the aspects of insurers' pricing which have contributed to high and increasing premiums in northern Australia.

Chapter 6—Profitability of insurers in northern Australia: sets out our approach to assessing insurers' profitability, and the various ways that profitability can be considered. It discusses the profitability of providing insurance in northern Australia and compares this to the rest of the country.

Chapter 7—Competition in northern Australian insurance markets: considers the competitiveness of markets for insurance in northern Australia. This includes how insurers compete, the availability of insurance to consumers, and the existence and extent of any barriers to entry, expansion or exit in the supply of insurance in northern Australia.

Chapter 8—Product characteristics, terms and conditions: considers the statutory concepts of the 'standard cover' regime, and the adequacy of existing regulatory requirements to disclose such derogations. It also looks at non-price differences and the lack of consistency in how insurers define certain terms.

Chapter 9—Consumer information and choices: discusses the information consumers receive and seek about their insurance choices and the decisions they need to make, including with respect to policy type and sum insured. It also considers choices consumers can make to improve their access to affordable insurance.

Chapter 10—Intermediaries and other third parties: considers the role and impact of insurer intermediaries and insurance brokers, including the potential conflicts that can arise through commission-based remuneration from insurers. We also consider the role of strata managers and the current disclosure and remuneration arrangements.

Chapter 11—Claims processes and dispute resolution: examines insurers' claims processes and the roles of loss adjusters and insurers' arrangements with builders and repairers. It also considers how claims are settled and dispute resolution options available to consumers.

Chapter 12—Mitigation: explores both private (property-level) and public (community-level) mitigation, including the extent and transparency of premium reductions made by insurers in recognition of mitigation activity. It also considers the importance of land use planning policies and building regulations to minimise risks for future developments.

Chapter 13—Where to next: The report concludes with an overview of our focus areas, recommendations and proposed approach to consulting on draft recommendations.

Acknowledgements

Our goal is to assist governments and industry stakeholders to address concerns about insurance affordability and availability, promote better informed and more competitive insurance markets and thereby make a difference for consumers in northern Australia.

We would like to acknowledge and thank the people of northern Australia and other key stakeholders for sharing their views, experiences and expertise with us throughout the northern Australia insurance inquiry to date. We recognise that providing input into a process such as this takes time and resources. Your effort has made an important contribution to the findings and recommendations set out in this report.

We would also like to acknowledge and thank the insurers that are active in northern Australia who have provided information to the ACCC, including voluntary information outside of our formal information gathering process.

We look forward to continuing our engagement with you for the duration of our inquiry.

2. Market structure

Key points

- There are currently eight insurers who underwrite the vast majority of home, contents and strata insurance in northern Australia. These insurers can either sell direct to consumers via a range of brands, via insurer intermediaries that sell insurance on behalf of the insurer or via insurance brokers who may help a consumer find a suitable product for their needs.
- There are three main products providing coverage for residential buildings and contents; home insurance (which provides cover for buildings only), contents insurance (which provides cover for contents only), or a combined home and contents product. Approximately 51 per cent of all home and contents insurance products sold are combined policies.
- Northern Australia forms a relatively small share of the national market for home, contents, and combined home and contents insurance products. In the 11 years to 2017–18, northern Australia represented about 5 per cent of the policies supplied nationally, but 9 per cent of total gross written premium and 11 per cent of total claims costs.
- Most insurers supply home, contents and strata insurance to consumers through multiple channels and under many different brand names (including those of insurer intermediaries). This allows insurers to take advantage of consumers' awareness of well-known brands and leverage consumer trust in certain brands.
- Three insurers receive a significant proportion of their total gross written premium for home and contents insurance through insurer intermediaries. However, for most insurers, the majority of their gross written premium comes directly via their own retail brands.
- The insurance broker market is predominantly made up of hundreds of small, privately owned businesses. However, to help these businesses realise the benefits of size and scale, many join an insurance broker member group.
- There are three major member groups, which appear to be growing in influence at a national level, increasing in members and the amount of premium written via their services.
- Insurers compete for the services of insurance brokers via the commissions they offer for placing a policy with that insurer. The ability of brokers to extract concessions from insurers does not necessarily translate to lower premiums for consumers.

2.1 Insurance markets structure

The following chapter provides an overview of the structure of insurance markets in Australia. Understanding the structure of the insurance markets is important to understanding competition in those markets, how insurance is sold to consumers, as well as the types of issues that can arise for consumers when purchasing insurance.

2.2 Insurance markets in northern Australia

Residential building (home), contents and strata insurance products are a form of general insurance known as householders insurance.[7] When an insurer enters an insurance contract with a consumer, they are said to underwrite the policy. That is, they accept liability and guarantee payment in case of loss or damage for certain events. For consumers, it can appear there are many different companies in Australia that provide householders insurance including providers of financial services, banks, motoring associations or large supermarket chains. However, the majority of insurance in Australia is underwritten by a smaller number of insurers that supply either directly to consumers via their own retail brands, or through intermediaries such as agents or distributors that act on behalf of the insurer.[8]

7 General insurance includes liability insurance such as compulsory third party (CTP) motor insurance, worker's compensation, professional indemnity insurance and public liability insurance, and property insurance such as home and contents insurance, travel insurance, and comprehensive motor vehicle insurance.

8 A general insurer is authorised to conduct new or renewal insurance business in Australia by virtue of determinations made by APRA under items 4 and 5 of Schedule 2 of the *General Insurance Reform Act 2001*.

There are eight insurers who underwrite the vast majority of home, contents and strata insurance in northern Australia.[9] These are:

- AAI Limited (Suncorp)
- Allianz Australia Insurance Limited (Allianz)
- Commonwealth Insurance Limited (CommInsure)
- Insurance Australia Limited (IAG)
- QBE Insurance (Australia) Limited (QBE)
- RACQ Insurance Limited (RACQ)
- Westpac General Insurance Limited (Westpac)
- Youi Pty Ltd (Youi).

Many insurers in Australia are owned or controlled by non-operating holding companies (NOHC). NOHCs are companies, incorporated in Australia, that do not carry on a business other than the business of ownership or control of other bodies corporate.[10] However, you do not need to be controlled by a NOHC to carry on the business of supplying insurance in Australia.

Consumers can either purchase insurance directly from an insurer, or via an intermediary. Intermediaries cover a variety of arrangements between insurers and third parties, including ‘distributors’ or ‘authorised representatives’ who sell insurance on behalf of the insurer (like Coles, Woolworths, or ANZ Bank) or brokers who may help a consumer find a suitable product for their needs.

Approximately 53 per cent of consumers buying home and/or contents insurance in northern Australia do so directly with the insurer. While approximately 38 per cent do so via an insurer intermediary and approximately nine per cent though an insurance broker. The use of intermediaries is slightly higher in northern Australia than in the rest of Australia, where approximately 59 per cent of consumers buy direct compared to approximately 35 per cent via an insurer intermediary and approximately 6 per cent through an insurance broker. Insurer intermediaries are much more prevalent in north Western Australia accounting for approximately 66 per cent of policies written in that area. For strata products, approximately 51 per cent of northern Australian strata properties obtain insurance via an insurance broker although this accounts for approximately 64 per cent of gross written premium.

Intermediaries may charge a fee for their services and/or receive a commission from the insurer they place a policy with. Intermediaries can either act on behalf of the insurer or the consumer when arranging insurance. A very small number of consumers obtain insurance through referrals from other businesses or comparison websites.[11]

In order to protect themselves against large losses from catastrophic events, insurers may also purchase their own form of insurance known as reinsurance. There are a number of forms of reinsurance. The most common are excess of loss reinsurance, where a reinsurer insures losses from a single event over a specified threshold in return for a reinsurance premium. The second most common is quota share or proportional reinsurance where the reinsurer pays a proportion of all the insurer’s claims for a share of the insurer’s premium revenue.

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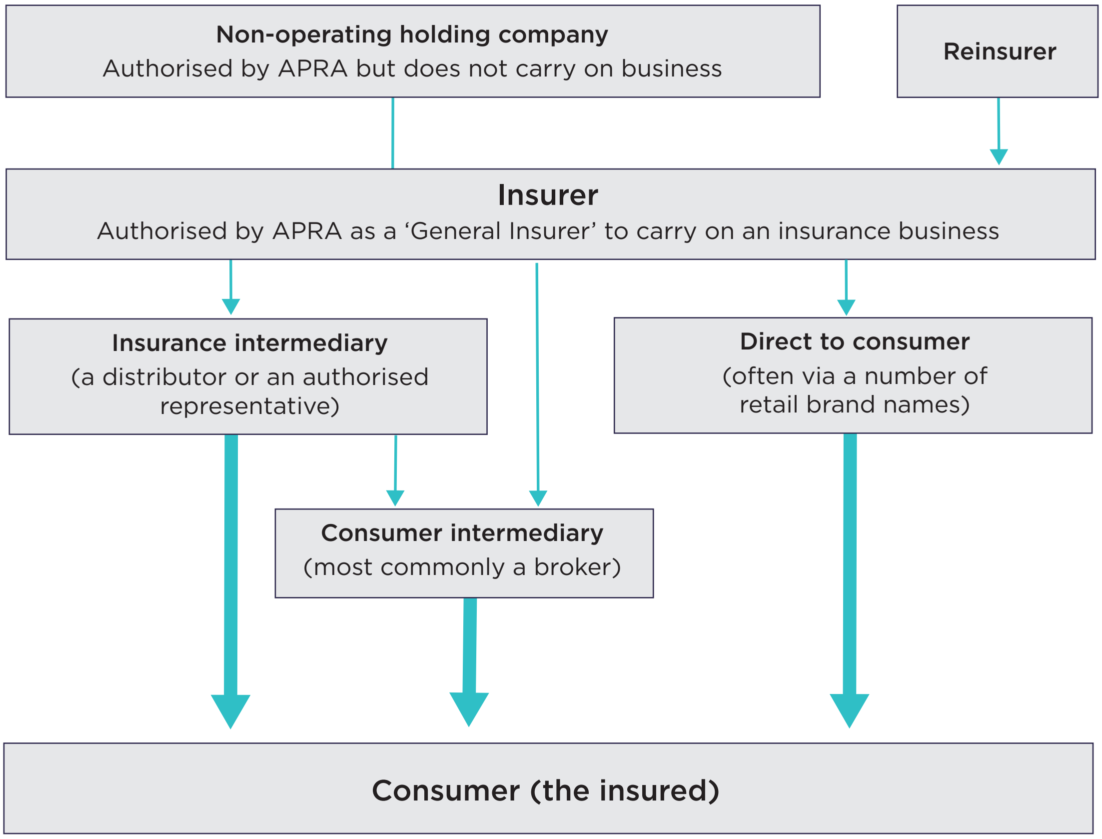
9 These eight general insurers also account for approximately 90 per cent of total gross written premium for home, contents and strata insurance nationally.

10 Insurance Act 1973 (Cth), s. 18 and APRA, *Guidelines on Authorisation of Non-Operating Holding Companies,* December 2007.

11 Chapter 10 considers the role of intermediaries and other third parties in more detail.

Figure 2.1: Overview of market structure for the supply of insurance to consumers



The general insurance industry in Australia is supervised by the Australian Prudential Regulation Authority (APRA). To provide general insurance in Australia, an entity must be licensed by APRA.[12] Insurers are governed by APRA's prudential standards that require insurers to hold a certain amount of capital and to implement certain governance and risk management procedures. These standards are designed to protect consumers, by ensuring insurers remain solvent and are able to pay claims.

Types of insurance products

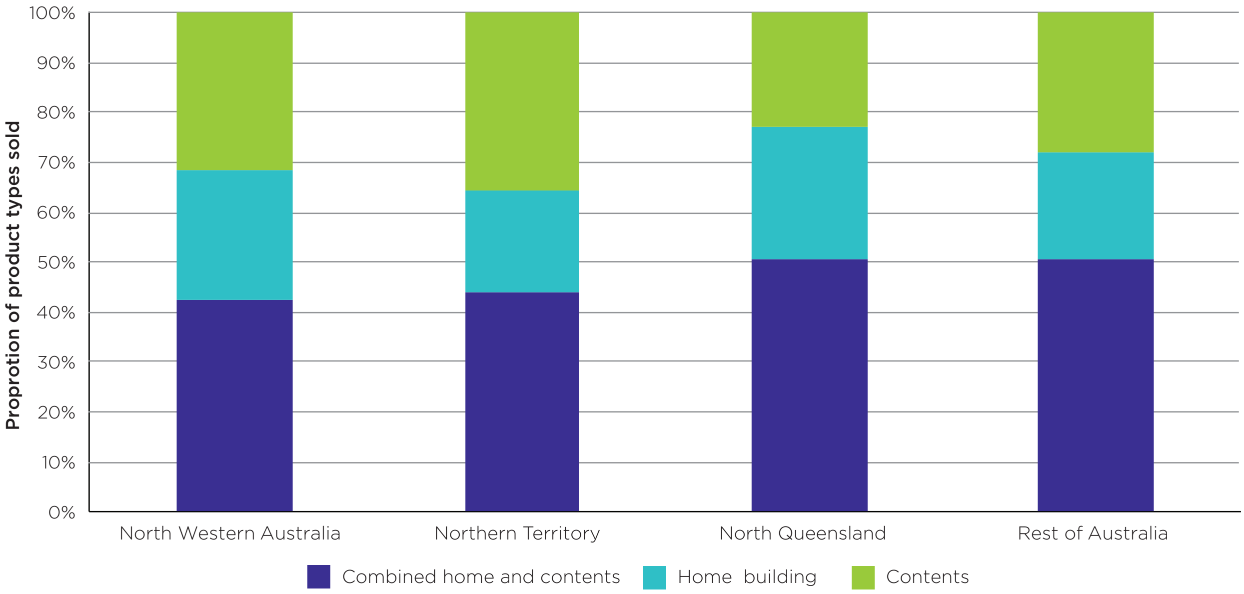
There are three main products providing coverage for residential buildings and contents:

- **Home insurance** provides cover for the insured building(s) only. Also referred to as 'building insurance', this will often be purchased by landlords (often as part of a landlord insurance policy which can include features like rental protection), and by people who have chosen to buy home and contents insurance from different insurers or brands.
- **Contents insurance** provides cover for contents only, and will often be purchased by renters and by people who have chosen to buy home and contents insurance separately from different insurers or brands.
- **Combined home and contents insurance** provides cover for both the home building and its contents.

Across Australia (including northern Australia), combined home and contents insurance products have the greatest uptake of the three products. In 2017–18 combined home and contents products made up about 51 per cent of the national market by number of policies. Contents insurance products made up about 28 per cent of policies and home building products about 21 per cent. This varies slightly across northern Australia, with a slightly greater portion of contents only policies in north Western Australia and the Northern Territory, and a smaller portion in north Queensland.

12 *Insurance Act 1973* (Cth), s. 12.

Figure 2.2: Proportion of product types for home and/or contents insurance, 2017–18



Source: ACCC analysis of data obtained from insurers.

Strata insurance is typically required by state and territory legislation to cover the estimated total cost of replacing the common property of the strata scheme. The type of property covered by strata insurance will depend on the nature of the strata property. For a multi-level apartment block, most of the building will be covered by the strata policy. However, for a complex with a number of free standing properties, the property covered by the strata policy may be more limited. Strata insurance does not provide coverage for residents' contents. Residents would generally hold separate contents insurance on an individual basis.

The size of home and contents, and strata insurance markets in northern Australia

As noted in the 2018 Update Report, home and contents insurance products in northern Australia form a relatively small share of the national market. In 2017–18 there were around 473 000 home and contents insurance products in northern Australia, representing about 5 per cent of the approximately 8.6 million products supplied nationally. Of these, 82 per cent are in north Queensland, 13 per cent in the Northern Territory, and five per cent in north Western Australia.

However, in terms of total premium, northern Australia represents a larger share of the national total. In 2017–18, insurers in northern Australia collected approximately $733 million in gross written premium, which is around 10 per cent of the estimated $7.3 billion paid to insurers by consumers nationally.[13]

13 Gross written premium excludes GST, levies and stamp duty.

Figure 2.3: Size of northern Australia home and contents insurance markets by number of policies and gross written premium as a percentage of national total, 2017–18

Source: ACCC analysis of data obtained from insurers.

The trend for strata insurance is similar, with northern Australian premiums making up a larger portion of the national totals than it does by policy numbers. We also note that the strata market in north Western Australia is particularly small, with only around 140 policies in 2017–18.

Figure 2.4: Size of northern Australian strata insurance markets by number of policies and gross written premium as a percentage of national total, 2017–18

Source: ACCC analysis of data obtained from insurers.

Claims in northern Australia also make up a higher proportion of national totals than policy numbers. Looking at the averages for all building and contents insurance over the last 11 years, northern Australia made up about five per cent of total policies, but around nine per cent of total gross written premium and 11 per cent of total claims costs. Claims trends are discussed in more detail in chapter 4.

Home, contents and strata is only a part of many insurers' business

In addition to home, contents and strata insurance, insurers also supply many other types of general insurance, such as motor, Compulsory Third Party (CTP), liability and commercial insurance products. For some insurers, revenue received from home, contents and strata insurance may account for less than a third of their total premium revenue. However, this is not the case for all insurers, particularly banks that offer home and contents insurance as a complementary product to their home loan products.

Overall this means that, home, contents and strata insurance written in northern Australia accounts for only a small proportion of total written premium for a number of insurers. For the largest insurer in northern Australia, Suncorp, northern Australia represents approximately 3.3 per cent of its overall gross written premium.

Home, contents and strata insurance is supplied through multiple channels

There are currently only eight insurers supplying (or underwriting) the vast majority of residential home, contents and strata insurance in northern Australia.[14] Suncorp, Allianz, CommInsure, IAG, QBE, RACQ, Westpac, and Youi operate in north Queensland, while Youi and RACQ generally do not supply in the Northern Territory or Western Australia.[15]

However, most insurers supply home, contents and strata insurance to consumers through multiple channels and under many different brand names.

Insurers supply products in various ways including:

- directly to consumers
- through an insurance broker
- through an insurer intermediary such as an agent or distributor
- following referrals to the insurer from other entities including comparison websites.

These channels are considered further in chapter 10.

Insurers supply insurance using multiple brands

Major insurers in Australia supply insurance directly to consumers under multiple brand names. For instance, Suncorp not only supplies insurance under the Suncorp name, but also AAMI, GIO, Vero and others. While IAG brands include NRMA, SGIO, SGIC, and CGU.

Many brand names used by the insurers were initially established as either state government backed insurance offices or state based motoring and mutual insurance associations.[16] Many of these brands are still the largest in their home states.

Insurers may also use particular brands to sell specific types of insurance (specialised brands). The best example of this is residential strata insurance, which for most insurers is sold through dedicated specialised brands.[17] These brands are known as intermediated brands as they do not sell direct to the public, but rather are only available via an insurance broker or other agent.[18]

More generally, insurance can also be sold under the brand of the intermediary. Where an insurance product is supplied through an insurer intermediary, the product may retain the brand of the insurer, the intermediary may apply its own branding to the insurer's product, or the product may be 'co-branded' by both parties. In all cases, the product is underwritten by the insurer, even when the intermediary

14 There are other insurers who supply a small number of policies in northern Australia, such as Hollard, Chubb and AIG.

15 Youi only has a very minor presence in north Western Australia.

16 A mutual insurance company is owned by policyholders.

17 For example, IAG sells strata insurance via the Strata Unit Underwriting agency, and Suncorp via Longitude and Resilium.

18 This is not to be confused with intermediary brands, which are brands used by intermediaries who sell insurance on behalf on an insurer.

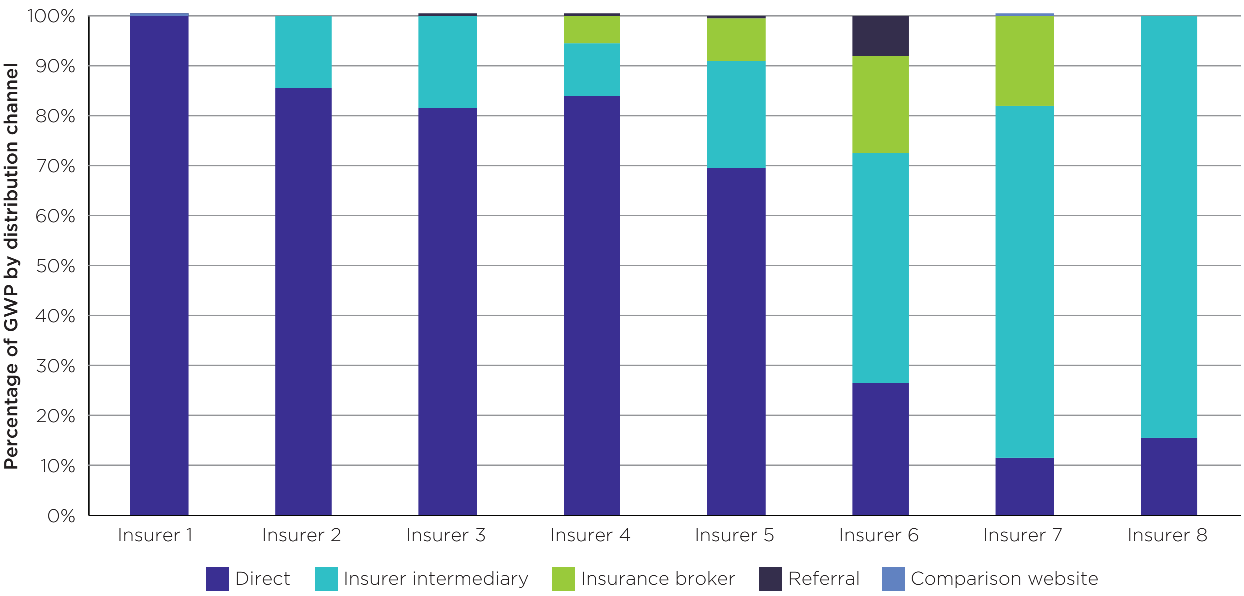
is another large financial institution, and this should be stated in the product disclosure statement provided to the consumer.

A key reason insurers supply insurance via a number of different brands (including those of an insurer intermediary) is that it allows them to take advantage of consumers' awareness of well-known brands. That is, they are able to leverage consumer trust in certain brands, such as the former government insurers and motoring associations. The advantage of this is illustrated by the market leading positions of these brands. Further, it allows them to take advantage of the marketing of their intermediaries' brands, for example Coles, Woolworths or ANZ bank, and reach consumer groups they may not otherwise target.

The range of brands can also be used to target different specific demographics such as Suncorp's Australian Pensioners Insurance Agency (APIA) specialising in providing insurance for people over the age of 50. Or QBE's Elders Insurance specialising in providing insurance for those that live in regional communities. These brands target these different consumer groups through marketing, but also via product pricing and coverage. This is discussed in more detail in chapter 7.

Three insurers receive a significant proportion of their total gross written premium for home and contents insurance through insurer intermediaries. However, for most insurers, the majority of their gross written premium comes directly via their own retail brands.[19]

Figure 2.5: Percentage of total gross written premium for home and contents insurance received by distribution channel for each insurer, 2017–18



Source: ACCC analysis of data obtained from insurers.

Not all insurers market their products via multiple brands or through insurer intermediaries. Youi and RACQ only offer insurance via those brand names respectively, while CommInsure only offers insurance under its own brand and its Bankwest brand name.

Insurance brokers and member groups

An insurance broker is a type of intermediary that acts on behalf of the consumer, and is usually licensed to provide a consumer with personal financial advice that takes into account the personal situation of the consumer and not just the features of their property. Brokers are paid a commission fee by the insurer that underwrites the client's policy and/or broker fees, which are paid directly by the consumer. Unlike other forms of financial advice, general insurance is excluded from conflicted remuneration provisions of the *Corporations Act 2001*. As such, insurance brokers are not bound by

19 Source ACCC: based on information provided by insurers.

the same provisions that aim to more closely align the interests of those who provide advice with the interests of their clients by prohibiting remuneration that could influence the choice of financial product recommended by the adviser.[20]

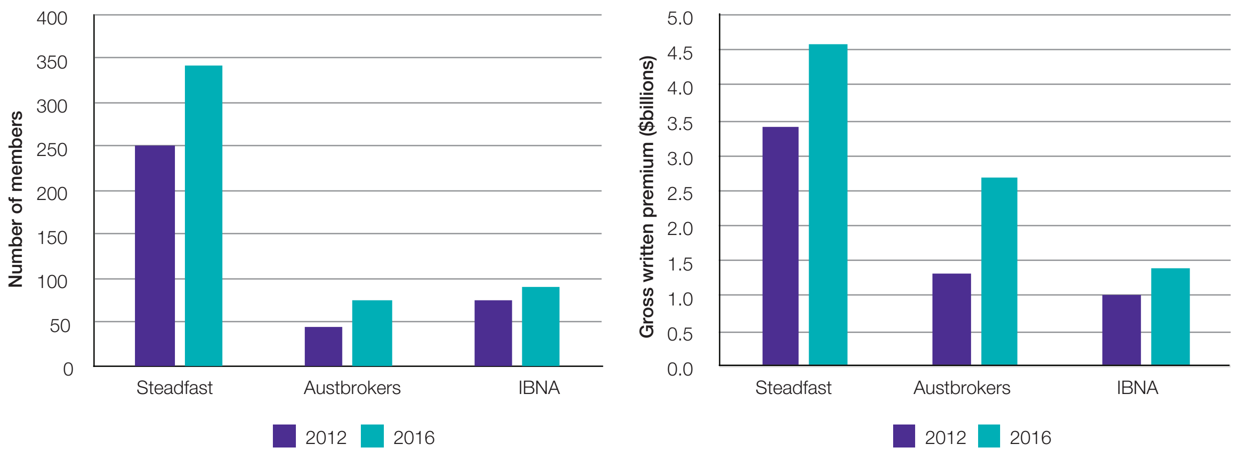
The insurance broker market is predominantly made up of hundreds of small, privately owned businesses. However, to help these businesses realise the benefits of size and scale, many join an insurance broker member group.

Broker member groups provide independent brokers with enhanced buying power and scale which allows them to better negotiate on policy terms and conditions with insurers. Member groups typically require an insurance broker to purchase a membership to the group and pay ongoing fees in order to gain access to certain policy offers from insurers and access to member group commission rates which can be higher than those offered to independent brokers. Member groups may also receive some or all of the extra commissions paid by insurers.

The insurance broker market is dominated by these member groups—the three largest by share of total premium placed for general insurance are Steadfast (28.3 per cent), Austbrokers (15.3 per cent) and IBNA (7.6 per cent).[21] These member groups also either have financial interests in, or partner with, underwriting agencies that are backed by the insurers. For example, Steadfast Group consists of the Steadfast broker network and also Steadfast Underwriting Agencies. This group of underwriting agencies includes strata insurance providers CHU and QUS (QUS is underwritten by AIG and only has a small number of policies in northern Australia).

Member groups appear to be growing in influence at a national level, with the big three (Steadfast, Austbrokers and IBNA) increasing in members and the amount of premium written via their services.

Figure 2.6: Growth in top three broker member groups by number of members and total gross written premium ($billions) for householders insurance, 2012–2016



Source: ACCC analysis of documents obtained from insurers.

Insurers compete for the services of brokers via the commissions they offer for placing a policy with that insurer. These commissions are usually not dependent on the level of service provided or the location of where the policy is placed, and as discussed in chapter 10, can result in conflicting interests for the broker.

For one insurer, it considered that a decision to reduce commission payable to brokers due to the product and line of business being loss making at the time, led to it being selected against i.e. many brokers only placed unattractive risks in high natural hazard areas with the insurer (where there is less choice of supply) and chose other underwriters for more benign risks due to their higher commissions.

Commissions payable to insurance brokers are typically factored into the premium levied by an insurer (not paid separately to the broker by a consumer). While an insurance broker would be expected

20 ASIC Regulatory Guide 246: *Conflicted and other banned remuneration*, December 2017.

21 IBIS World K6420 Insurance Brokerage in Australia.

to seek lower premiums on behalf of their clients, this is unlikely to be at the expense of their own commissions. As a senior manager at one insurer noted in 2015:

> *'Having large premium decreases on renewals reduces our credibility. This is worse in the intermediary market where the intermediary sees this multiple times in contrast to direct customers who only see their own individual policies. Intermediaries want to see their commission income at least maintained, not reduced. This is a problem for them that has been raised in the past quite vehemently... Regions indicated that if the negative collars are excessive, intermediaries will demand that they individually reduce the collars to zero for their account no. or ask for commission rate increases. The regions said that they want to avoid both of these scenarios.*
>
> *Premium stability is highly important because the broker can move the entire portfolio if rates change too fast too quickly. And where rates are not generally required to increase by large amounts, it affords us the opportunity to move to technical rates more gradually, particularly if retention is moving towards its maximum levels. Balancing this, we need to get both our new business and renewal books as close to correct technical rates as quickly as possible to ensure that we get the right selection of risks and maintain profitability'*

As such, the ability of brokers to extract concessions from insurers does not necessarily translate to lower premiums for consumers. In order to regain their business, the insurer in the first example increased the amount of commission payable to brokers and recouped potential losses by increasing its base premium rates.

Chapter 10 considers the role of intermediaries in more detail.

3. Insurance prices in northern Australia

Key points

- This chapter builds on the work of previous inquiries which have considered premiums in northern Australia. It provides consumers, governments and stakeholders with the most comprehensive picture of insurance prices in northern Australia to date. It contains insights drawn from a significant amount of information not available to previous inquiries.
- We have found that home and contents premiums are, on average, considerably higher in northern Australia than the rest of Australia. For example, combined home and contents insurance products in the north of Western Australia have the highest average annual premiums ($3500), followed by north Queensland ($2400) and the Northern Territory ($2200). The average in the rest of Australia is $1300, half the northern Australia average.
- Home and contents insurance has become significantly more expensive over the last decade. For example, combined home and contents premiums rose by 130 per cent in real terms in northern Australia between 2007–08 and 2017–18, compared to just over 50 per cent in the rest of Australia.
- In the same period, average premium per sum insured ratios for combined home and contents insurance in north Western Australia and north Queensland increased by 44 per cent and 71 per cent respectively.
- In 2017–18, strata insurance was also more expensive in northern Australia, with the ratio of premiums to sum insured between 1.7 and 3.8 times higher than in the rest of the country. Strata premiums have also increased over the past eleven years, but, as for home and contents insurance, premium increases in northern Australia appear to be slowing in recent years.
- Many local residents and property owners in northern Australia face home and contents premiums that are much higher than these averages. Consumers in the Pilbara, and coastal north Queensland pay the highest premiums on average. Many in these areas may face premiums of more than $4000.
- Average premiums in the highest priced parts of northern Australia can be up to five times the level of the average in the rest of Australia. Many parts of northern Australia with lower average premiums, still pay more for insurance than most other parts of the country.
- The premiums paid by individual consumers in some areas may also be significantly higher (or lower) than the average for their postcode. The spread of premiums paid within a postcode is larger on average in northern Australia.
- The range of premiums has also increased in northern Australia, with the difference between the upper and lower quartile of combined home and contents insurance increasing significantly.
- Northern Australians have higher excess levels on average than consumers in the rest of Australia. For north Queensland and north Western Australia the selected excess is between 50 and 60 per cent higher than the rest of Australia.

Our analysis of industry data confirms that premiums for home, contents and strata insurance have risen considerably over the last decade and are much higher in northern Australia than in other parts of the country. This chapter discusses these premium trends in detail looking first at home and contents insurance and then at strata insurance.

This chapter provides consumers, governments and stakeholders with the most comprehensive picture of insurance prices in northern Australia to date. It contains insights drawn from a significant amount of information not available to previous inquiries.

3.1 How we have reported premium trends

Unless otherwise indicated, in this chapter premiums:

- are the average of the premiums for insurance products supplied by insurers at a postcode or regional level

- include GST, stamp duty and applicable levies
- are presented in real terms (in 2017–18 dollars); this means that reported premiums for previous years have been adjusted upwards to remove the effect of general price inflation on price trends
- are based on information reported to the ACCC by insurers.

The premium figures in this chapter only represent actual prices paid by consumers for insurance, unless otherwise indicated. They do not include quoted premiums that were not ultimately taken up by consumers for various reasons, such as a consumer being unable to afford the insurance (chapter 9 discusses non-insurance issues) or do not purchase insurance for any other reason.

There are a number of factors that can affect the premium paid by a consumer for home and contents insurance. Two factors which can have a significant impact on the premium paid are the amount for which the property is insured (the sum insured) and the excess level selected. To take account of differences between the average sums insured in different postcodes and regions, it is useful to compare the premium paid per amount of sum insured (the premium per sum insured ratio). The premium per sum insured ratios in this chapter are calculated by comparing the total premium paid in a region with the total sum insured in that region.

Sums insured, particularly for buildings, can increase over time for a number of reasons and these reasons can often be beyond a consumer's control. In particular increasing building costs which feed into sum insured calculators provided by insurers are often a reason that the suggested sum insured (and often the minimum sum) increase from one year to the next.

The estimated sum insured for a building will be based primarily on the estimated rebuilding cost (and in some cases, an extra allowance for ancillary costs). Building costs are generally higher in northern Australia for a variety of reasons, such as remoteness and the application of higher building standards (considered further in chapters 4, 11 and 12). As a result, a house with particular characteristics may have a considerably higher estimated sum insured in northern Australia than it would in a capital city. Higher average sums insured do not necessarily indicate larger or higher quality homes.

At an aggregate level, changing sums insured also reflect changes in the overall housing stock (but only for insured property).

While some consumers will increase their building sum insured to reflect property improvements or extensions, in many cases, these adjustments are the result of automatic indexing or follow the suggested sums insured of insurers. Where the sum insured increases due to increases in building costs generally, premiums will also rise. Where this occurs, a consumer will be paying a higher premium, but insuring the same property.

Taken together, this suggests that the ratio of premium per sum insured can be useful for comparing premiums in aggregate between areas or products. However, the fact that the premium per sum insured has increased at a lower rate than the average premium does not make it easier for a consumer to afford a rising premium.

We have also considered the effect that excess levels can have on premiums by looking at trends in excess levels later in this chapter.

The impacts of high premiums on consumers, and the measures taken in response, are explored in detail in chapter 9.

3.2 The price of home and contents insurance in northern Australia

As part of our Inquiry, we obtained detailed information about pricing across Australia over an eleven year period, from 2007–08 to 2017–18. In our 2018 *Update report* we presented some preliminary findings based on this data (up to 2016–17). We found that average premiums in northern Australia for combined home and contents products were around $2000 per annum, which was double the average for the rest of Australia.[22] We also found that premiums had risen more rapidly in northern Australia than the rest of Australia over the last decade, but also observed that premiums can vary substantially across northern Australia.

This section of the paper builds on the analysis in the *Update report*, but provides more detailed analysis of premium levels and trends for home and contents insurance. It also includes observations about prices for the last financial year, compares prices for different types of insurance cover and looks closely at pricing in a number of postcodes across northern Australia.

Stakeholder views and previous reports on insurance premiums in northern Australia

Previous reports have described the increasing cost of insurance premiums in northern Australia. For instance, in 2014 the Australian Government Actuary (AGA) found that on average between 2009–10 and 2012–13, home and contents premiums in north Queensland increased by around 80 per cent.[23]

In 2015, the Northern Australia Insurance Premiums Taskforce found premiums in towns across northern Western Australia had increased by between 60 and 100 per cent between 2011 and 2015.[24]

Submissions to our inquiry from local residents and property owners, advocacy groups, industry bodies and insurers were consistent with these findings. We have heard consistently from consumers in northern Australia that their premiums were increasing, and that it is becoming difficult to afford adequate insurance coverage. For example, the Town of Port Hedland submitted that since 2009–10 insurance costs for residential properties in the Pilbara have increased rapidly, and that they were between 600 and 1000 per cent higher than in Perth.[25] The Town of Port Hedland stresses that the affordability of insurance has reached unsustainable levels.[26] The high cost of insurance was also the dominant theme at the public forums we held throughout northern Australia.[27] We discuss local residents and property owners' views about premium levels further in chapter 9.

Industry also acknowledges that premiums in northern Australia are generally higher and that they have increased quite significantly over time. The ICA provided figures that the median 'normalised' (to a $350 000 sum-insured and $500 excess) home building policy in northern Australia is around $1350, compared to $575 in the south of Australia.[28] However the ICA queries whether the issue of high pricing in northern Australia has sometimes been overstated and submits that less than three per cent of policyholders are paying more than $3000 for home building insurance (for a standardised policy with a sum-insured of $350 000, and excess of $500).[29] Our findings on average are discussed in detail below.

Allianz considers that premium rises have 'moderated over the last couple of years' but accepts that they have increased, particularly for those in northern Australia, over the decade to 2015. Allianz also notes that premiums for properties exposed to high cyclone or high flood risk, can be very expensive. It submitted that industry data suggests that contents insurance in northern Queensland is about 2.5 times the price compared to Queensland's southern cities for properties with no or negligible flood risk. Allianz also submitted that there can be wide variation in premiums faced by owners, and that in circumstances (such as where the building was constructed before building standards were introduced or was constructed of weatherboard not brick, or was on the side or top of a hill) premiums in cyclone areas can be up to ten times the level of premiums in areas not vulnerable to cyclones. It provided examples of home building premiums that were currently being paid by Allianz policyholders in north

22 Note that these figures did not include GST, duties or levies.

23 Australian Government Actuary, *Report on home and contents prices in north Queensland*, November 2014, pp. 3, 7–8. AGA based these observations on data provided voluntarily from five insurers: Allianz, IAG, QBE, RACQ Insurance, and Suncorp.

24 See Northern Australia Insurance Premiums Taskforce, *Final Report*, November 2015. These observations were based on data provided by the Western Australian government.

25 Town of Port Hedland submission, pp. 1–2.

26 Ibid.

27 Summaries of the public forums can be found at the ACCC's website.

28 ICA submission, pp. 3–4. This figure comes from the ICA's policy-in-force dataset. Which is an ICA collected dataset which it states contains policy records for approximately 10 million policies in Australia that were in-force as at 1 November 2017.

29 Ibid, p. 27.

Queensland and Western Australia, and stated that, 'It is surprising to find some of our customers can afford such premiums'.[30]

In contrast, Suncorp submitted that pricing analysis undertaken for previous inquiries 'have not indicated widespread affordability problems for northern Australia'. It considers that higher premiums in much of the media reporting are 'typically outliers that reveal high risk properties'.[31]

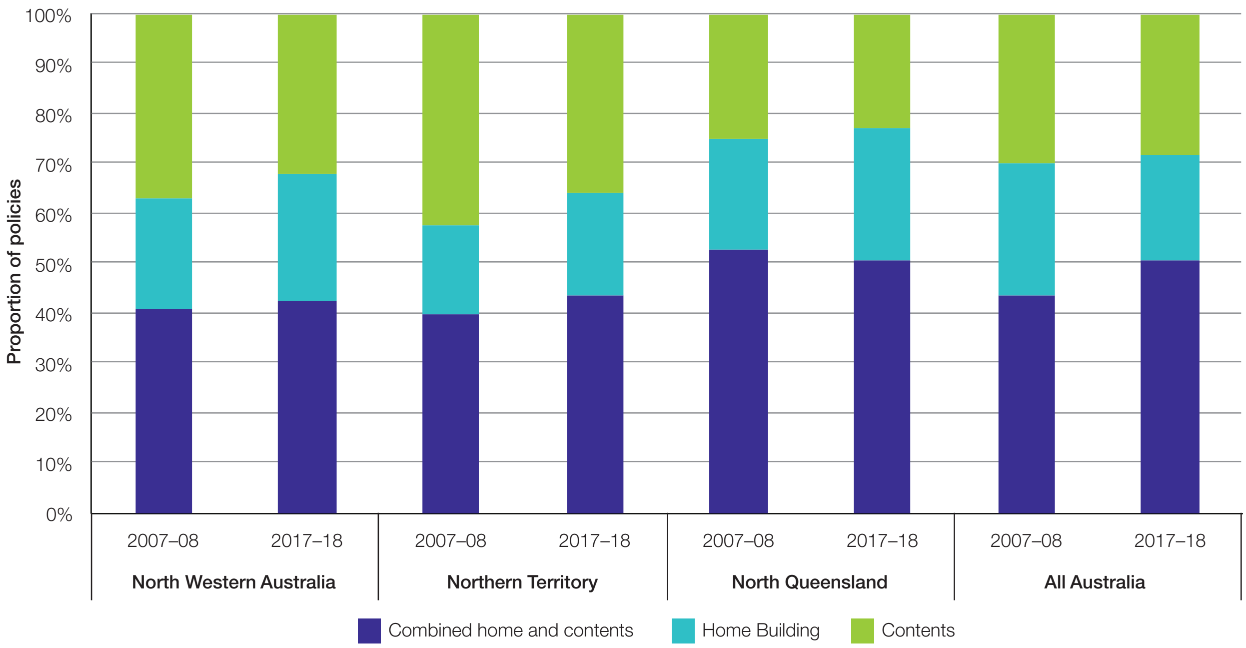
Home and contents insurance products

Insurers provide building and contents insurance through three main products. These are:

- **Home insurance** provides cover for the insured building(s) only. Also referred to as 'building insurance', this will often be purchased by landlords (often as part of a landlord insurance policy which can include features like rental protection), and by people who have chosen to buy home insurance and contents insurance from different insurers or brands.
- **Contents insurance** provides cover for contents only, and will often be purchased by renters and by people who have chosen to buy home insurance and contents insurance from different insurers or brands.
- **Combined home and contents insurance** provides cover for both the home building and its contents.

Across Australia, combined home and contents insurance products have the greatest uptake of the three products. In 2017–18 combined home and contents products made up about 51 per cent of the market by number of policies. Contents insurance products make up about 28 per cent of policies and home building products about 21 per cent. This varies slightly across northern Australia, with a slightly greater portion of contents only policies in north Western Australia and the Northern Territory, and a smaller portion in north Queensland. Figure 3.1 shows the proportion of each home and contents product northern Australia. It also shows that the proportion of products in the regions has not changed greatly between 2007–08 and 2017–18.

Figure 3.1: Proportion of product types for home and/or contents insurance, 2007–08 and 2017–18



Source: ACCC analysis of data obtained from insurers.

30 Allianz submission, p. 13.

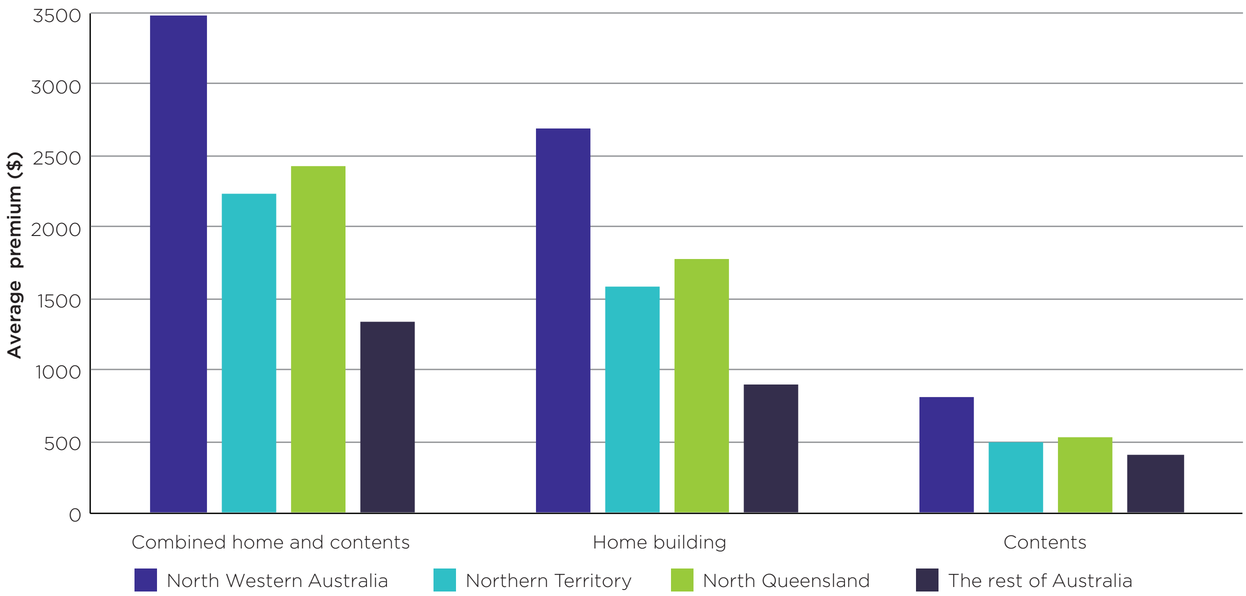
31 Suncorp submission, pp. 13–14.

How much does home and contents insurance currently cost?

Average premiums paid

In 2017–18, average premiums paid by consumers were higher across northern Australia than the rest of Australia for all three product types, but were highest in north Western Australia. Figure 3.2 compares average premiums for all home and contents insurance products.

Figure 3.2: Average premium paid for home and contents insurance, 2017–18



Source: ACCC analysis of data obtained from insurers.

For the 2017–18 financial year, the average premium for combined home and contents insurance across northern Australia (not shown above) was approximately $2400, nearly twice the average annual premium for the rest of Australia of $1300. Premiums were highest in north Western Australia at $3500 per year or 2.6 time the price in the rest of Australia, followed by north Queensland at $2400 a year, and then the Northern Territory at $2200 a year.

For home building insurance, average premiums in northern Australia in 2017–18 were about $1800, twice the average for the rest of Australia of $900. The average premium paid for Western Australia was three times the price for the rest of Australia at $2700 per year, followed by north Queensland which double the price at $1800 per year. Average premiums in the Northern Territory were also higher at $1600 per year.

Contents insurance was also higher in northern Australia than the rest of Australia, but the difference between northern Australia and the rest of Australia was not as pronounced. Average premiums for northern Australia were $540 per year, which is 1.3 times the average premium for the rest of Australia of $400 per year. Average premiums in north Western Australia are the highest at $800 per year, double the average for the rest of Australia, and the Northern Territory the lowest at $500 a year, 1.2 times the price in the rest of Australia.

Premiums per sum insured

As noted above, while average premium figures provide a good indication of the actual prices consumers pay for insurance, they do not take into account the differences in the sums insured. We have therefore also considered premiums per sum insured across northern Australia.

As shown in table 3.1, average sums insured under contents insurance products are generally lower in northern Australia than they are in the rest of Australia. However, with the exception of north Queensland, average sums insured under home building insurance products, and combined home and contents insurance products are similar or higher in northern Australia than they are in the rest of Australia. The relatively low average sum insured under home insurance policies in north Queensland may be due to differences in housing characteristics of insured properties and/or indicate a degree of underinsurance.

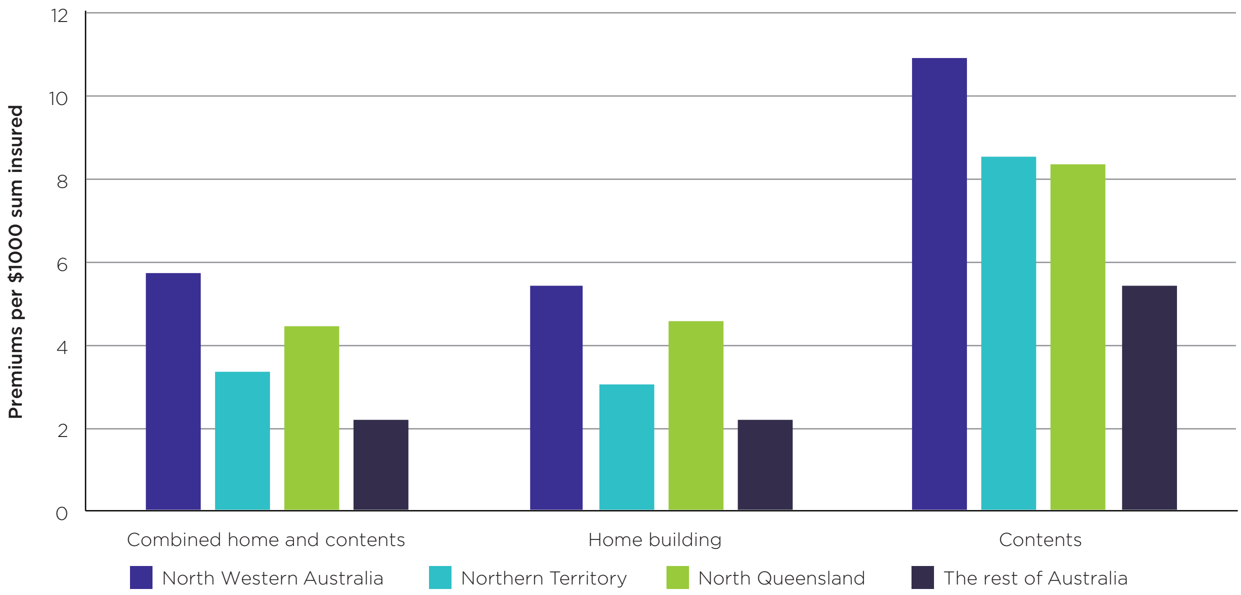
Table 3.1: Average sums insured under home and contents insurance products, 2017–18

Region	Combined home and contents ($)	Home Building ($)	Contents ($)
North Western Australia	615 000	498 000	74 000
Northern Territory	668 000	524 000	58 000
North Queensland	546 000	390 000	63 000
The rest of Australia	616 000	425 000	75 000

Source: ACCC analysis of data obtained from insurers.

Figure 3.3 shows the premium per $1000 sum insured for the three home and contents products across the regions in 2017–18. Overall, premiums per sum insured in northern Australia were between 1.4 to 2.6 times the premium per sum insured for the rest of Australia. For example, the premium per sum insured for combined home and contents products in northern Australia was $4.30 for every $1000 insured, which is nearly double the average for the rest of Australia of $2.20 for every $1000 insured. The premium per $1000 insured for home insurance was also twice the average for the rest of Australia, at $4.40 per $1000 sum insured compared to $2.10 per $1000 sum insured for the rest of Australia.

Figure 3.3: Premium per sum insured for home and contents insurance, 2017–18



Source: ACCC analysis of data obtained from insurers.

Figure 3.3 also shows that premiums per sum insured are generally higher for contents insurance than for home insurance throughout Australia. In northern Australia, average premiums are $8.50 per $1000 insured compared to $5.40 for the rest of Australia. Further, premiums per sum insured for combined building and contents, and home building products are highest for north Western Australia, followed by north Queensland and then the Northern Territory. Contents insurance had a similar trend, although Northern Territory premiums were slightly higher than in north Queensland. This is similar to the trends for average annual premiums paid, but the relative differences between regions are not identical for the two measures due to differences in average sums insured.

Insuring contents is relatively more expensive than insuring buildings

The premium per sum insured for contents insurance is nearly double the cost of home building insurance in most regions. As noted above, in 2017–18, the average premium for home building insurance in northern Australia was $4.40 per $1000 insured, while contents was $8.50 per $1000 insured. This suggests that people with a contents only policy are paying more relative to the value of property being insured.

We saw similar trends when comparing the cost of building cover and contents cover in a combined home and contents product. On average, across all of Australia, the building component of a combined home and contents policy accounts for about 70 per cent of the premium, and the contents component about 30 per cent. However, of the total sum insured under a combined policy around 80 per cent is for building and only 20 per cent for contents.

The above trends are most relevant to the Northern Territory and north Western Australia where there is a larger proportion of contents only policyholders.

Combined policies offer cheaper cover

Across Australia, the cost of both home cover and contents cover is cheaper (in terms of premium per sum insured) as part of a combined home and contents product than as a standalone product. Looking at average premiums per sum insured for the whole of Australia, home insurance is about 20 per cent higher as a standalone product than as part of a combined home and contents insurance product, while contents cover is around 30 per cent more as shown in table 3.2 below.

Table 3.2: Premium per $1000 insured for combined and standalone building and contents cover, 2017–18

	Premium per sum insured building	Premium per sum insured contents
Combined	1.91	4.10
Standalone	2.27	5.52

Source: ACCC analysis of data obtained from insurers.

This means that consumers seeking only building or contents cover, such as renters and landlords, will pay more for their cover (measured in terms of premium per sum insured) than consumers purchasing a combined home and contents product. This would also be the case for consumers looking to obtain home insurance and contents insurance through separate brands of insurers.

Excess levels in northern Australia

Looking at average premiums as we have above does not take into account differences in the excess levels selected by consumers. As we discuss in more detail in chapter 5 and chapter 9, selecting a higher excess will result a lower premiums as it means that the consumer has retained a higher amount of risk and the insurer will have a lower claims frequency and lower claims costs. Therefore looking at the average excess levels is important when considering the average premium figures.

Table 3.3 shows the impact on quoted premiums from increasing the excess for combined home and contents insurance policies. Comparing excess across insurers is complicated as excess options vary across insurers. Table 3.3 compares differences in average quoted premiums when the median level of excess is raised from $1500 to $5000, or lowered from $1500 to $500. When excesses were raised to a level with a median of $5000, average quoted premiums reduced by between 13 and 21 per cent. Conversely, when excesses were lowered to levels with a median of $500, average quoted premiums increased by 15 to 18 per cent. This also indicates that this effect is asymmetrical—bigger increases in excess amounts would be expected to decrease premiums, but at a decreasing rate.

Table 3.3: Percentage difference in combined home and contents insurance quoted premiums with different median excess amounts (2018)

Region	Raising median excess from $1500 to $5000	Lowering median excess from $1500 to $500
Northern Territory	-13%	15%
North Queensland	-15%	16%
North Western Australia	-21%	18%

Source: ACCC analysis of quote data provided by Finity Consulting. Quote data was based on a sample of quotes obtained from insurers' websites.

We note that there was considerable variation between insurers' premiums as excess levels changed, and the above indicates the average change of premium across insurers. It should be noted that this large range can be partly attributed to the differing range of excess levels the insurers had available.

In 2017–18, the average excess level selected by a policyholder in north Queensland and north Western Australia was between around 50 to 60 per cent higher than average excess levels selected by policyholders in the rest of Australia for home insurance and the building component of combined home and contents insurance. However, for the Northern Territory, excess levels for these products are lower than the average for the rest of Australia. The average excess levels for these regions are shown in table 3.4.

The difference in excess levels for contents insurance and the contents component of combined home and contents insurance is smaller, and average excess amounts in northern Australia are generally much closer to those in the rest of Australia. This may because average premiums for contents insurance are lower than for home building insurance, and as a result consumers may be less likely to choose higher excess levels to reduce their premiums than they are for home insurance.

Table 3.4: Average excess levels selected for home building, contents and combined insurance policies, 2017–18

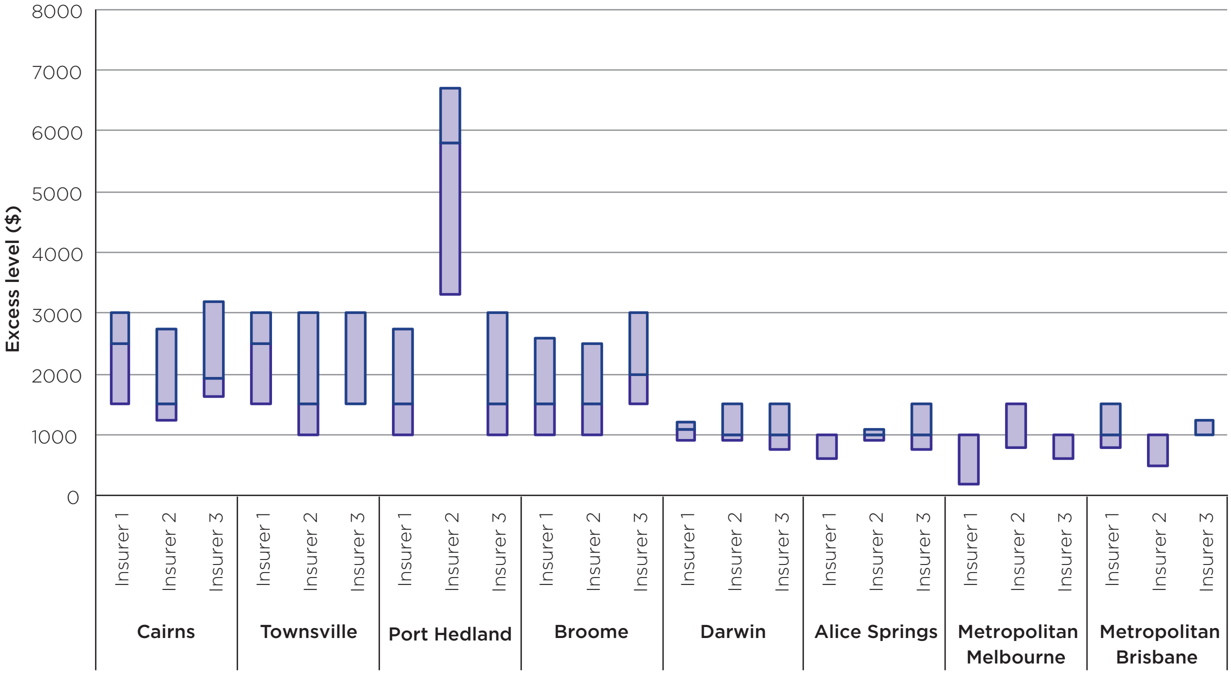
	Home (building) insurance ($)	Combined home and contents—building excess ($)	Combined home and contents—contents excess($)	Contents insurance($)
North Western Australia	1 200	1 000	620	430
Northern Territory	720	630	530	420
North Queensland	1 200	1 100	650	440
The rest of Australia	760	680	500	390

Source: ACCC analysis of data obtained from insurers

As noted above, selecting a higher excess will reduce a consumers' premium to some extent. We have not been able to adjust premiums to take different excess levels into account. However, as excess levels selected by consumers in north Queensland and north Western Australia are higher on average, it appears that, if adjusted to account for excess levels, average premiums for combined and home insurance products in north Queensland and north Western Australia would exceed those from the rest of Australia by an even greater margin.

It also appears that the range of excess levels are higher in northern Australia than the rest of Australia, and that a greater number of consumers are opting for high excess levels. Figure 3.4 provides an indication of the distribution of excess levels in a selection of areas in northern Australia and outside of northern Australia.

Figure 3.4: Lower quartile, median and upper quartiles of excess levels selected for combined home and contents insurance products, 2017–18



Source: ACCC analysis of data obtained from insurers.

Note: The lower end of the bars represents the lower quartile, the dividing line the median, and the top of the bar the upper quartile. Insurers differ between regions

The above illustrates, for example, that the median and upper quartiles selected by consumers for combined home and contents insurance, of a number of insurance brands in parts of north Queensland and north Western Australia is higher than for some metropolitan centres outside of northern Australia. Further for these areas, it also appears that a number of consumers select excess levels about $2500. Conversely, excess levels selected in parts of the Northern Territory are closer to levels in the selected Metropolitan centres. This may be because on average premiums in the Northern Territory are lower, and consumers here may not use excess as a way to lower premium levels to the same extent as those in north Queensland and north Western Australia.

We note that the above only shows excess data for a small selection of areas, but we have observed similar excess levels in other parts of northern Australia. Further, we have also observed that on average the median and upper quartile values for selected excess levels are higher in northern Queensland and north Western Australia than they are in the rest of Australia. However, we will also be looking more closely at excess levels in parts of northern Australia in the case studies discussed in focus area 2.

Further, we also note that while increasing excesses can lower premiums, there is a limit to the extent that this can assist consumers. For example, although it appears that in the Port Hedland region excess levels are higher than the rest of Australia on average, and a higher proportion of consumers in the region appear to have excesses over $2000, it still has some of the highest premiums in Australia.

Excess levels have also increased more substantially in north Queensland and the north of Western Australia than in the rest of Australia over the last eleven years. Between 2007–08 and 2017–18 average excess levels increased by approximately 340 per cent in north Queensland and 290 per cent in north Western Australia, compared to 150 per cent in the rest of Australia. The increase in the Northern Territory was smaller than in the other northern Australian regions, increasing by 180 per cent

Reasons for the difference in premiums

We have found that there are a range of reasons premiums in northern Australia are higher than in the rest of the country. These include the higher risk profile of the region, higher reinsurance costs, and subdued competition in much of the region. Chapters 4, 5, and 6 discuss the factors which have contributed to higher premiums in northern Australia in more detail.

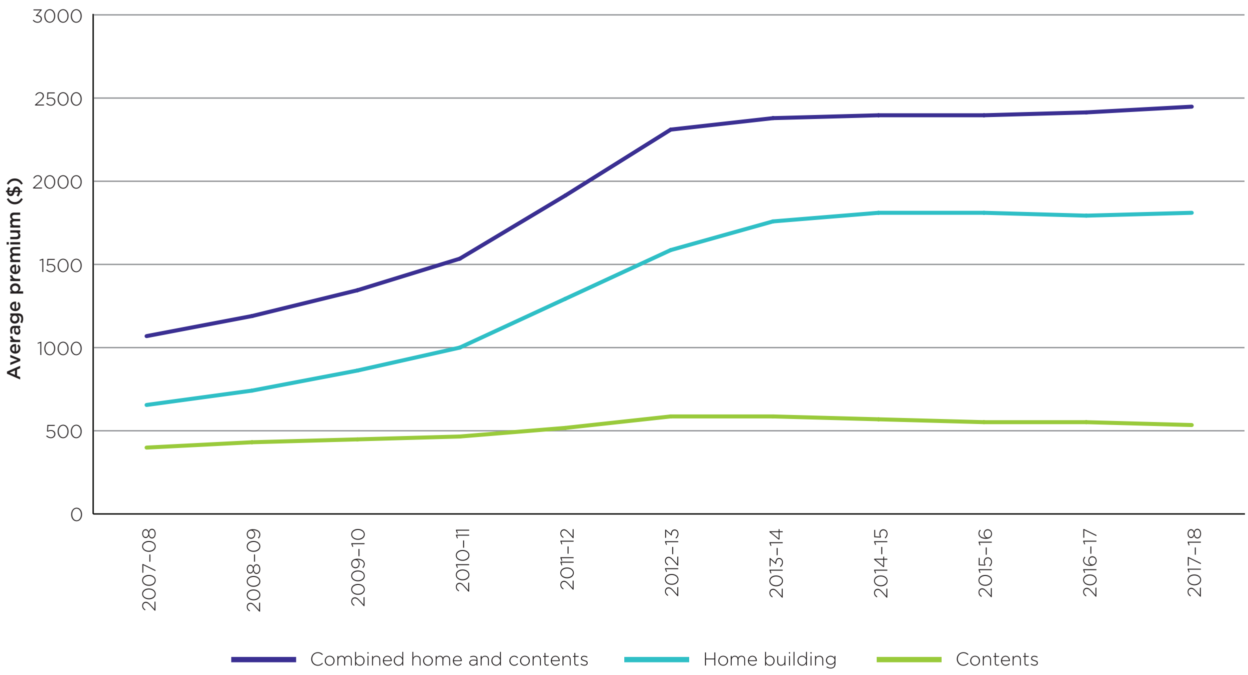
Increases in home and contents insurance premiums in the last decade

The premiums described in the previous section are the continuation of significant changes in the structure and levels of insurance premiums throughout northern Australia over the last decade. This section explains these changes at the level of northern Australia generally, and then at a regional level. The following section will consider other variations in premiums.

Premium trends across northern Australia

Premiums for home and contents insurance have increased considerably in northern Australia over the past 10 years. Between 2007–08 and 2017–18, the greatest increases in average annual premiums were for standalone home insurance, which rose by nearly 180 per cent in real terms across northern Australia, while standalone contents insurance rose by just under 40 per cent. The increase in average premiums for combined policies sat between the two standalone products, increasing by about 130 per cent over the period. This is illustrated by figure 3.5, which shows how average premiums for home and contents insurance products have changed across northern Australia in real terms between 2007–08 and 2017–18.

Figure 3.5: Average premiums for home and contents insurance products in northern Australia, 2007–08 to 2017–18, real $2017–18

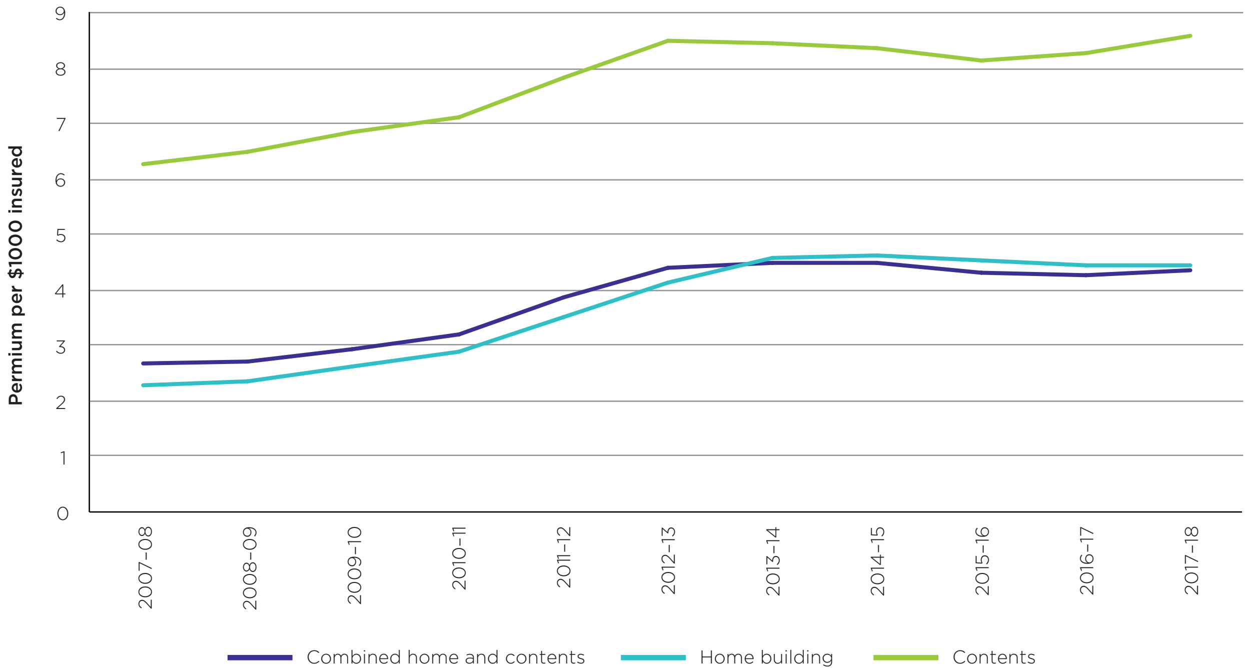


Source: ACCC analysis of data obtained by insurers

One reason for the greater increase in average premiums for home insurance compared to contents insurance is the changes in the sums insured under these policies. In northern Australia between 2007–08 and 2017–18 the average sum insured for home insurance has increased in real terms by 43 per cent compared to a one per cent for decrease for contents insurance.

When changes in the sums insured are taken into account, by looking at the change in premium per sum insured, the trends for standalone home insurance and contents insurance products are more similar, although the increase for home insurance is still greater. This is illustrated in figure 3.6, which shows how premiums per sum insured have changed between 2007–08 and 2017–18. Overall, premiums per sum insured have increased by approximately 63 per cent for combined home and contents insurance, 95 per cent for home building insurance and nearly 37 per cent for contents insurance. The greatest increases were between 2010–11 and 2013–14, but premiums per sum insured have been relatively stable since then.

Figure 3.6: Average premiums per sum insured for home and contents insurance in northern Australia, 2007–08 to 2017–18



Source: ACCC analysis of data obtained from insurers.

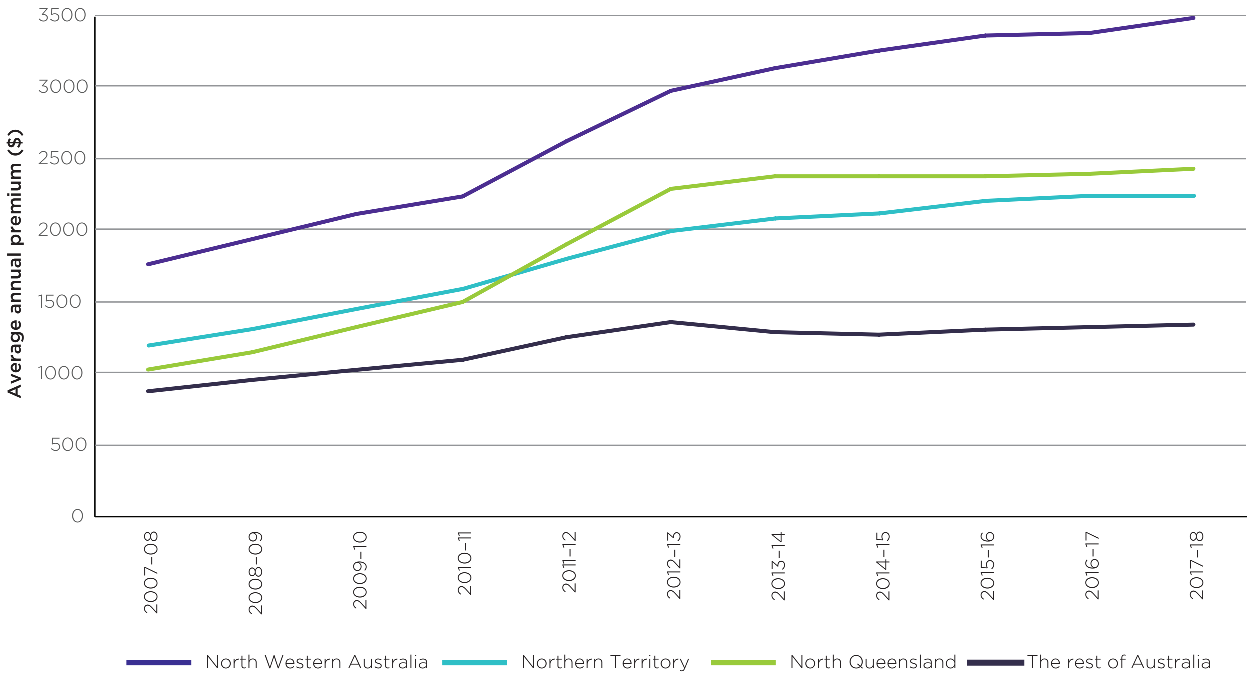
We have seen a range of factors have been contributing to higher premiums in northern Australia. A key trend that we observed was that many insurers reassessed the way that they set insurance premiums following high catastrophe claims in 2010–11. As a result the accuracy and granularity of many insurers pricing methodologies improved significantly, which led to premiums for many high risk areas in northern Australia increasing. Similarly, the costs of providing insurance in northern Australia have increased, and these appear to have been passed on to consumers through higher premiums. These issues are discussed in detail in chapters 4 and 5.

Average premium trends for each region in northern Australia

This section looks more closely at premium trends in each region of northern Australia. It considers trends in combined home and contents insurance only. However, we note that broadly trends in home building and contents premiums were similar.

Between, 2007–08 and 2017–18, average premiums outside of northern Australia increased by $470, or over 50 per cent in real terms, and have been fairly steady in more recent years. In northern Australia the extent of the increase has been greater, as illustrated in figure 3.7.

Figure 3.7: Average premiums paid for combined home and contents insurance products, 2007–08 to 2017–18, real $2017–18



Source: ACCC analysis of data obtained from insurers.

Note: Trends for the Northern Territory do not include data for the TIO prior to 2015–16.

During the eleven year period, average annual premiums for north Queensland increased most significantly in percentage terms, rising by nearly 140 per cent, or $1400 in real terms. This was followed by north Western Australia where average annual premiums increased by almost 100 per cent, or $1700.

As for the whole of northern Australia, the largest increases in average premiums occurred between 2010–11 and 2012–13 in north Queensland and north Western Australia. In this period, average premiums increased in real terms by about 53 per cent in north Queensland and 33 per cent in north Western Australia compared to 24 per cent in the rest of Australia. Since this increase, premiums in north Queensland have increased at a slower rate in line with the rest of Australia, while those in north Western Australian have continued to rise by at a lower rate.

We also note that a factor that has likely led to a small increase in premiums after 2013–14 in north Queensland was an increase in the stamp duty rate (which is included in the above average premium figures). From 31 July 2013, the stamp duty rate in Queensland increased from 7.5 per cent to nine per cent. The effect of stamp duties on premiums is considered in chapter 5.

Trends in the Northern Territory

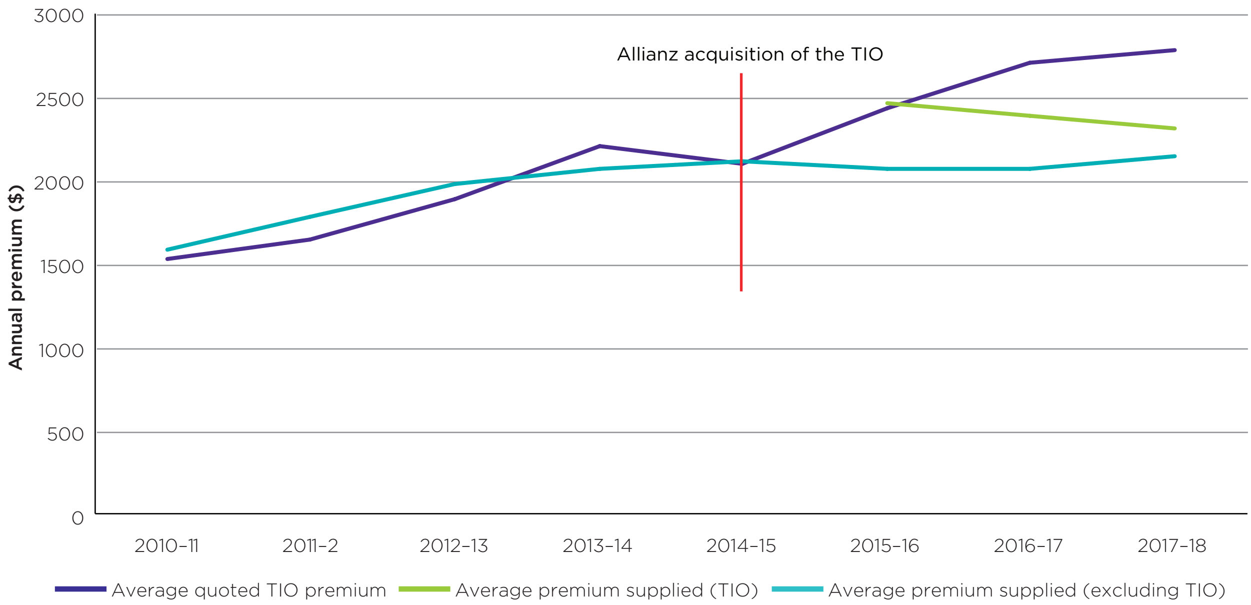
Figure 3.7 suggests that average premiums in the Northern Territory have also increased steadily between 2007–08 and 2017–08, rising by nearly 90 per cent. However, we note that prior to 2015–16 we have not been able to consider policy data from the TIO.[32] The TIO had a large share of the home and contents insurance market in the Northern Territory during this period, at around 60 per cent. As a result, we note that average premiums for a large part of the market in the Northern Territory have not been include in figure 3.7 and therefore average premiums for the Northern Territory prior to 2015–16 would differ from those shown in the figure.

While we have not been able to consider the premiums for home and contents insurance products that were supplied by the TIO during this earlier period, we have obtained historic data on premiums

32 This is because the TIO was acquired by Allianz on 1 January 2015, and, to date, we have not been able to obtain historic data about premium pricing before this time.

offered by the TIO (i.e. historic quote data).[33] Figure 3.8 shows the average premium quoted by the TIO for combined home and contents insurance and (from the data obtained from insurers) the average premium supplied to consumers in the area excluding the TIO between 2010–11 and 2017–18. It also shows actual TIO premiums from 2015–16 to 2017–18.

Figure 3.8: Average quoted premiums for the TIO and average premiums supplied for combined home and contents insurance in the Northern Territory, 2010–11 to 2017–18, real $2017–18



Source: ACCC analysis of data obtained from insurers and quote data provided by Finity Consulting. Quote data is based on a sample of quotes obtained from a sample of insurers' websites.

The figure shows that between 2015–16 and 2017–18 average TIO premiums for combined home and contents were higher than the average for the rest of the industry in the Northern Territory. It also shows that the average quoted TIO premiums trended in line with the average premium supplied in the Northern Territory by other insurers until around 2015 when the TIO was acquired by Allianz.

It is difficult to determine how actual premiums prior to 2015 would be affected if TIO data was included, as quoted prices for the TIO may differ from the prices of policies that were actually supplied by the TIO. This is because premiums depend on a range of factors, most notably sum insured, location and excess. As the quotes will not fully represent the characteristics across the Northern Territory they will likely differ from the average premiums. We also note that the quote data may not fully represent quoted premiums across the Northern Territory as they are based on only a sample of quotes. However, the above suggests that the TIO's average premiums in the Northern Territory increased following the acquisition by Allianz.

We note that the TIO as a government owned insurer had historically used community rating to set premiums and that insurers have moved away from community rating to remain competitive (as discussed in Chapter 5). This may, at least in part, explain the above trends. We note that Allianz submitted to the ACCC that:

> *'The increase in average premium by Allianz following the acquisition resulted from the introduction of address based pricing, consistent with the pricing model that was applied by other insurers. [I]n order to remain competitive, Allianz needed to ensure the comparatively large proportion of high risks in its newly acquired Northern Territory portfolio were charged the appropriate premium for their specific risk. This was achieved (in part) by an increase to average premiums.'*

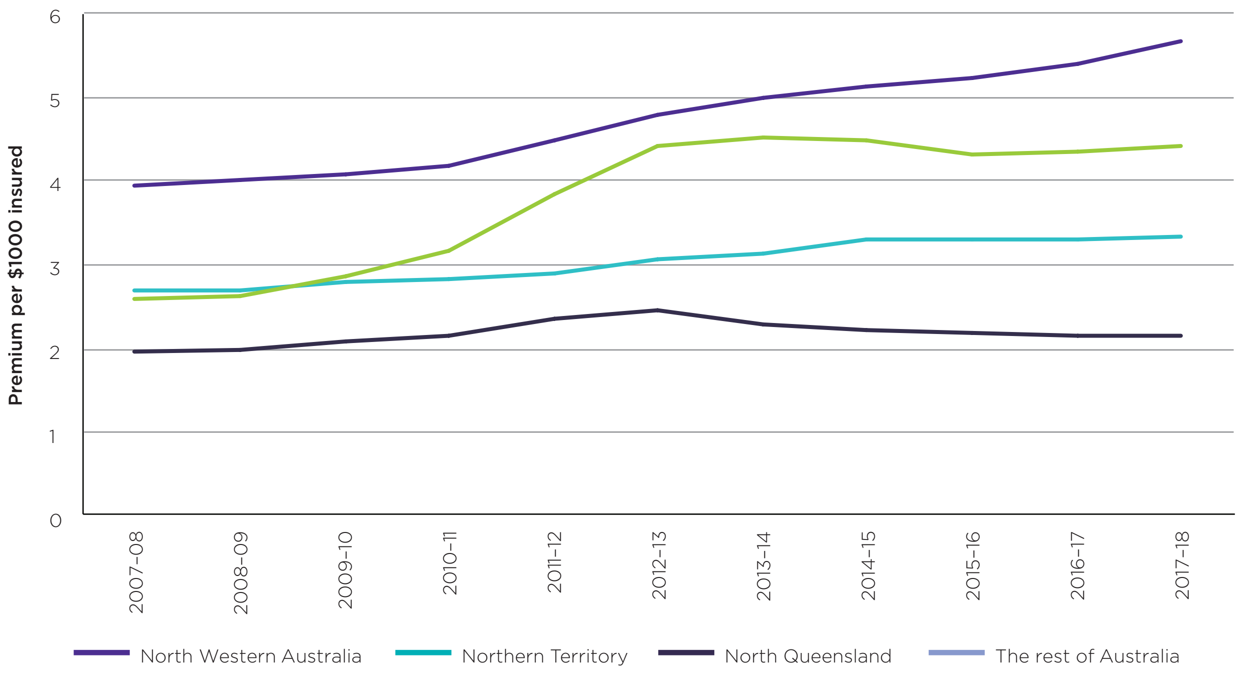
We will continue to consider premium trends in the Northern Territory as the inquiry progresses.

33 These figures are based off 20 000 quotes taken across the NT for policies insuring between $250 000 and $500 000 sum insured for building and between $40 000 and $85 000 for contents. The sum insured for combined policies is equal to the sum of both the building and contents coverage, for a range of $290 000 to $585 000.

Premiums per sum insured in each region of northern Australia

Figure 3.9 below shows how premiums per sum insured have changed between 2007–08 and 2017–18. The increase in premiums per sum insured is not as large as the increase in average premiums paid, but the rate of increase in northern Australia has still been greater than in the rest of Australia, particularly for north Western Australia and north Queensland.

Figure 3.9: Premium per $1000 sum insured for combined home and contents policies, 2007–08 to 2017–18, real $2017–18



Source: ACCC analysis of data obtained from insurers.

Note: Trends for the Northern Territory do not include data for the TIO prior to 2015–16.

In north Western Australia, the premium per sum insured has risen steadily since 2010–11. Between 2007–08 and 2017–18 the premium per sum insured rose by 44 per cent. The most significant increase has been in north Queensland, where the premium per sum insured has increased by 71 per cent over the 11 year period. A significant reason for this increase was the jump in premiums between 2010–11 and 2012–13 where premiums per sum insured increased by 40 per cent. Following this increase, the average premium per sum insured has remained fairly flat, and has fallen slightly over the past three years.

Premiums per sum insured in the rest of Australia have been fairly flat over the period, and have only increased by 10 per cent. We observed a slight increase between 2008–09 and 2012–13, but premiums per sum insured have fallen since this time.

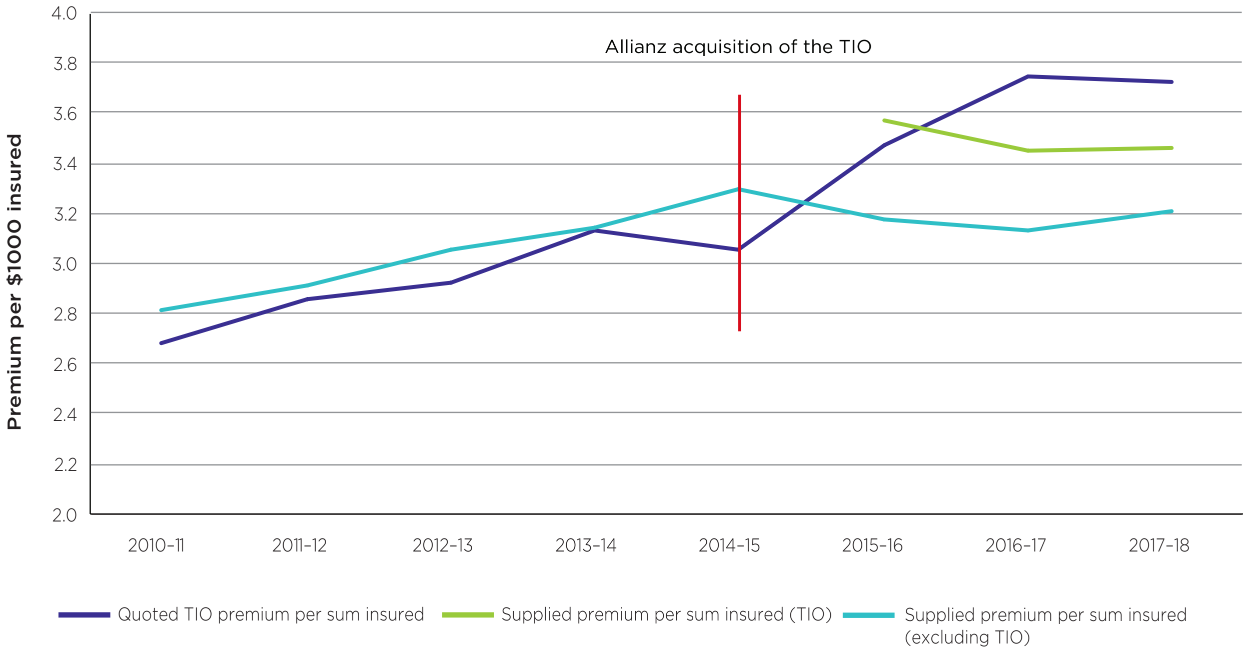
However, as noted earlier, a flat or declining ratio of premium per sum insured should not be used to infer a stabilisation or improvement in affordability.

Premium per sum insured trends in the Northern Territory

Premiums per sum insured in the Northern Territory have not increased to the same extent, rising by around 11 per cent. Figures for the TIO have not been included in the premium per sum insured figures prior to January 2015, as we were unable to obtain the relevant data. As for average premiums, we have looked instead at TIO quoted premiums per $1000 insured to get a more complete picture of insurance pricing in the northern Territory.

Figure 3.10 contrasts the TIO's quoted premiums per sum insured with premiums per sum insured for combined home and contents insurance actually supplied by all insurers (except for the TIO), between 2010–11 and 2014–15. It also compares actual TIO premiums per sum insured from 2015–16 onward.

Figure 3.10: Quoted premiums per sum insured for the TIO and average supplied premiums per sum insured, for combined home and contents insurance in the Northern Territory, 2010–11 to 2017–18



Source: ACCC analysis of data obtained from insurers and quote data provided by Finity Consulting. Quote data is based on a sample of quotes obtained from a sample of insurers' websites.

Figure 3.10 shows that TIO quoted premiums per sum insured were similar to the average for home and contents products supplied in the Northern Territory between 2010–11 and 2015–14. It shows that that quoted premiums per sum insured have increased for the TIO following the Allianz acquisition, after being relatively close to the industry wide average. It also shows that from 2015–16 the supplied premium per sum insured for the TIO was higher than the industry wide average. Again, we cannot be certain about how actual premiums per sum insured for the TIO would compare to the quoted figures, and the quoted figures may not fully reflect the quoted premiums across all of the Northern Territory. However, the above suggests that TIO premiums per sum insured have increased following the acquisition.

We also note that, as discussed above, the move away from community rating may have affected TIO premiums per sum insured following the Allianz acquisition.

Changes to average sums insured

Over the last 11 years, the average sum insured in each region also increased. Table 3.5 shows the current average sum insured in each region, as well as the percentage increase between 2007–08 and 2017–18.

Table 3.5: Average sum insured for combined home and contents, 2007–08 to 2017–18, real $2017–18

	Average sum insured 2007–08 ($)	Average sum insured 2016–17($)	Percentage increase
North Western Australia	445 000	615 000	38%
Northern Territory	443 000	668 000	51%
North Queensland	395 000	546 000	38%
The rest of Australia	443 000	616 000	39%

Source: ACCC analysis of data obtained from insurers.

Note: Average sums insured do not include TIO data for 2007–08.

Overall, the average sums insured across Australia do not vary significantly. Both north Queensland and north Western Australia currently have lower average sums insured than the rest of Australia. Further the increase in the sums insured over the period for these regions is similar to that for the rest of Australia. This, along with premium per sum insured trends discussed above, suggests that it is not higher sums insured in Northern Australia which are leading to higher premiums. Further, in 2017–18, average premiums in the Northern Territory are only eight per cent higher than in the rest of Australia. However, the increase in the average sum insured in the Northern Territory is greater than the other regions, and has therefore likely contributed to premium increases to a greater extent.

Home building and contents product trends

The trends we observed for home insurance and contents insurance were similar and are illustrated in table 3.6 below.

Table 3.6: Increases in average premium paid and premiums per sum insured, 2007–08 to 2017–18, real $2017–18

	Real increase in average premium paid			Increase in premiums per sum insured		
	Combined	Building	Contents	Combined	Building	Contents
North Western Australia	99%	97%	64%	44%	42%	56%
Northern Territory	88%	120%	30%	24%	51%	46%
North Queensland	137%	196%	35%	71%	111%	34%
The rest of Australia	54%	78%	0%	10%	36%	9%

Source: ACCC analysis of data obtained from insurers.

Table 3.6 shows that for all products premiums in northern Australia increase to a greater extent than they did in the rest of Australia over the 11 year period. This is also the case for premiums per sum insured. We note that the increased premiums per sum insured for home building insurance in north Western Australia is similar to the rest of Australia. However, when considered in terms of the dollar increase, the increase in north Western Australia are much larger, increasing by $1.60 per $1000 insured, compared to $0.60 per $1000 insured in the rest of Australia. That is, the cost to insure a home with a sum insured of $400 000 increased by $640 on average in Western Australia compared to $240 in the rest of Australia.

Table 3.6 also illustrates that the scale of the increases in premiums per sum insured for contents insurance were generally smaller than the increases for home building or combined insurance. Further, we note that until around 2009–10 premiums for contents insurance were very similar in the Northern Territory, north Queensland and the rest of Australia. However from 2010, they began to diverge, with premiums paid in northern Australia increasing, while premiums in the rest of Australia remained fairly stable.

Variation in premiums across northern Australia

The above analysis provides averages and trends across the three regions in northern Australia, and the rest of Australia. While this gives a good indication of the scale of pricing issues for consumers in northern Australia, it does not fully reflect the level of premiums being faced by many consumers. This section looks at a number of areas where premiums appear to be particularly high to provide a better picture of the scale of pricing issues being faced by residents in northern Australia.

Allianz recognised this in its submission, stating, '..considering affordability issues based on a comparison of average premiums can be instructive, but it has limits in any broader discussion about home insurance affordability'.[34] Allianz provided examples of premiums paid for its home and contents insurance in northern Australia, showing that to insure a $160 000 building in Western Australia cost $4774 per annum, and to insure a $395 178 building cost $14 521 per annum.[35]

It was also reflected in comments we received from northern Australia residents, local government and regional development groups, and consumer representatives. For example, one resident said, 'I didn't know that it would be that expensive and that difficult to get a house insurance in Exmouth. Our house insurance was increased by 40 per cent in the last year even though we didn't make a claim and

34 Allianz submission, p. 14.

35 Ibid.

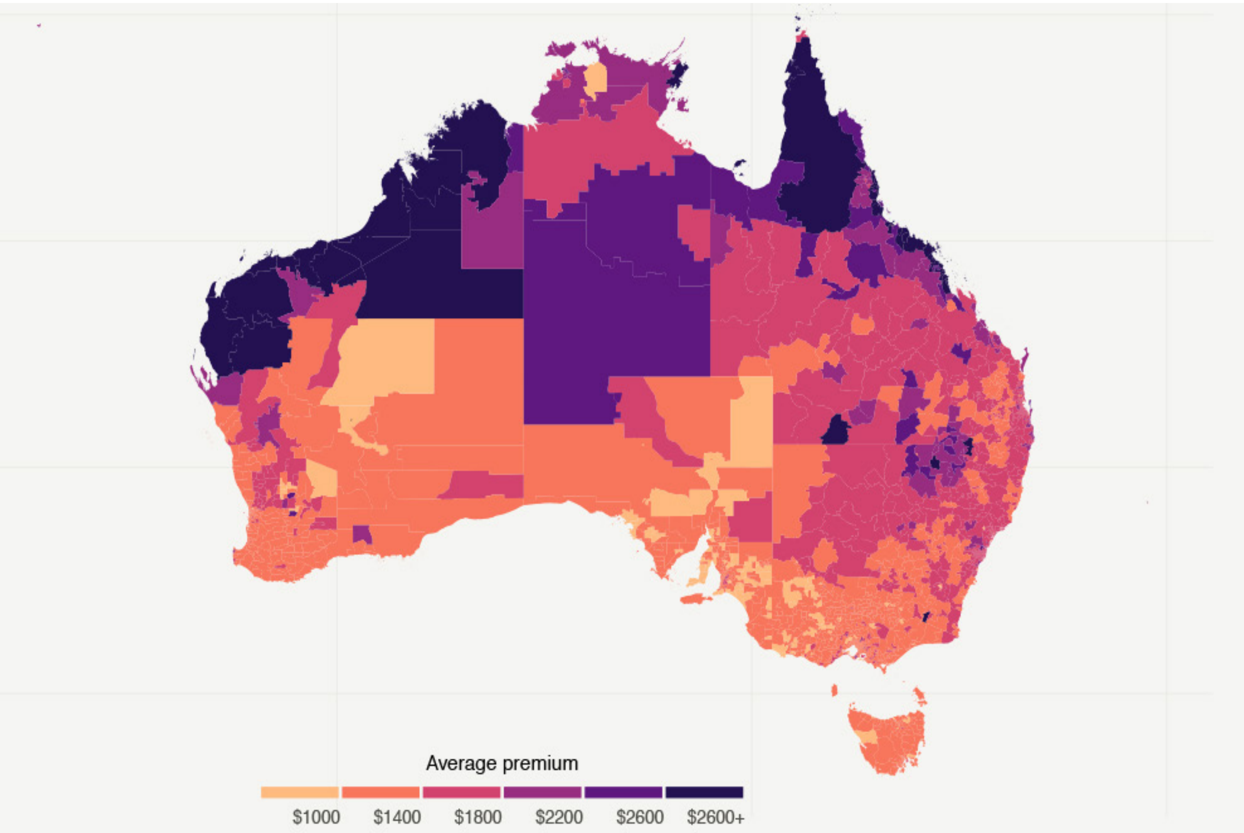
live in a new house. I tried to get a cheaper price but most insurances don't insure in Exmouth at all and if the price is ridiculously high'.[36] Another resident submitted that they received quotes of between $5000 and $14 000, and advised this is why they no longer have insurance.[37] The submission from the Town of Port Hedland represented the concerns of the local community more broadly, drawing on past research to indicate the rapid rise in residential and business insurance costs in the Pilbara area, which it says is mainly due to high claims for natural disasters in north Queensland and the Northern Territory. Community concerns about increasing premiums are discussed in more detail in chapter 9.

While many residents are facing premiums far above the regional averages, this also means there are parts of northern Australia where premiums are lower than the average, and more comparable with areas in the southern part of Australia. Further, there are also areas in the southern part of Australia which also face very high premiums. These are also discussed below.

Highest premium areas in northern Australia

Many areas in northern Australia have average premiums which are significantly above the northern Australian average. Further, it also appears that in general, the highest premium areas are concentrated in northern Australia. The following map at figure 3.11 shows how average premiums vary across northern Australia.

Figure 3.11: Average premiums for combined home and contents insurance in Australia, 2017–18



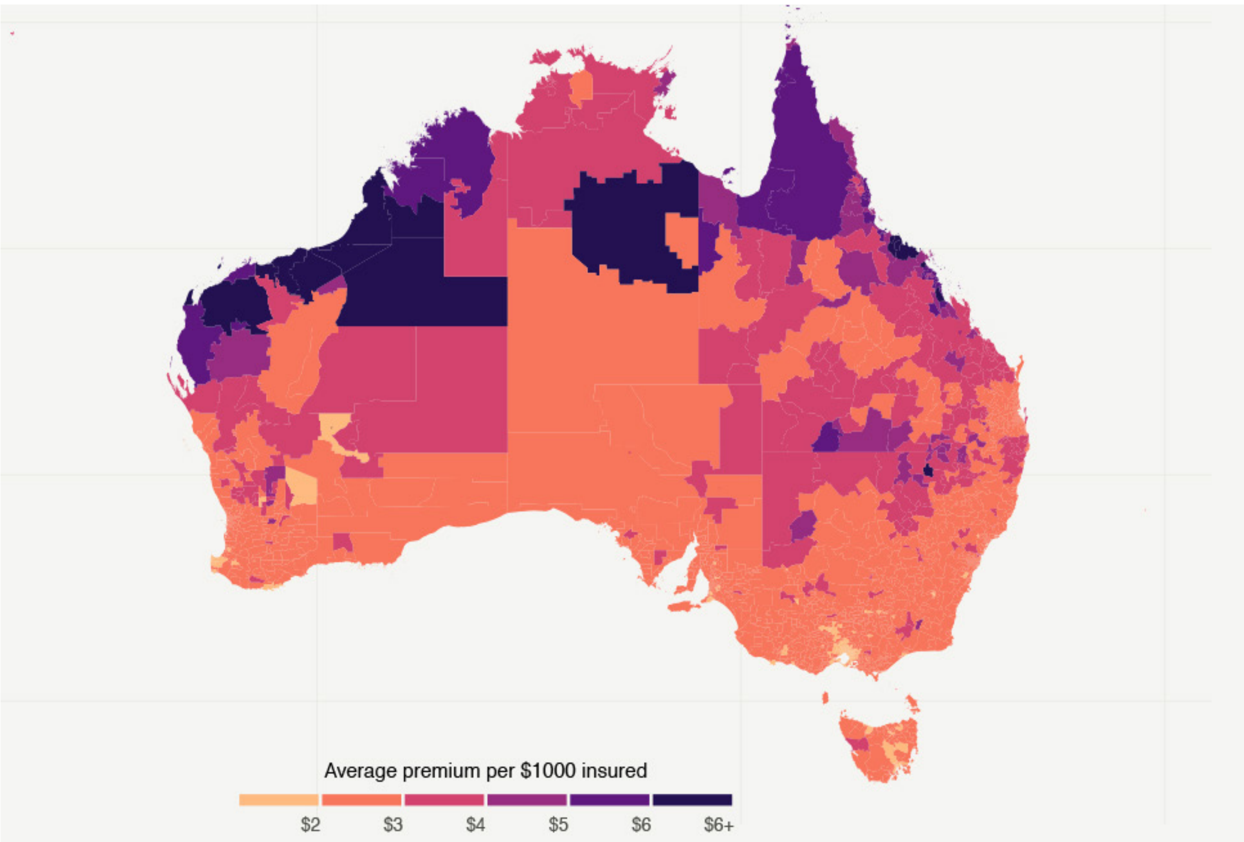
Source: ACCC analysis of data obtained from insurers.

The figure shows that average premiums are highest throughout large areas of north Western Australia, the central/southern region of the Northern Territory, and the coastal area of north Queensland. There are also areas where premiums are high outside of northern Australia, although these are not as widespread. In particular, northern NSW and southern Queensland appear to have premiums which are on par with the more expensive parts of northern Australian. Figure 3.12 shows that premiums per sum insured are also generally highest in northern Australia.

36 Submission from Anonymous 67.

37 Submission from S. Clayton.

Figure 3.12: Premiums per sum insured for combined home and contents in Australia, 2017–18



Source: ACCC analysis of data obtained from insurers.

In addition, we have considered the areas across Australia which have the highest premiums and premiums per sum insured. Of the 50 areas with the highest average premiums, 43 are within northern Australia. For the highest premiums per sum insured, 45 of these 50 are within northern Australia.

The ten postcodes with the highest average premiums paid in Australia (excluding postcodes with less than 20 policies supplied), and highest premium per sum insured ratios, for combined home and contents products are listed in table 3.7 and table 3.8.[38]

Looking at average premiums paid, we see that they are between three and ten times the average price for the southern part of Australia. Eight of the most expensive regions are located in the north of Western Australia, which is consistent with that region having the highest average premiums in northern Australia.

38 We have not included postcodes with fewer than 20 policies as they may lead to misleading results.

Table 3.7: Areas with highest average annual premiums for combined home and contents insurance, 2017–18

State	Postcode	Area	Average premium paid ($)
Qld	4803	Hamilton Island	13 135
WA	6710	Cane, Onslow, Peedamulla, Yannarie region	5 638
WA	6713	Dampier, Dampier Archipelago	5 521
WA	6720	Cossack, Point Sason	5 340
WA	6721	Port Hedland, Indee, Mundabullangana, Wallareenya	4 932
WA	6707	Exmouth/Exmouth Gulf region	4 669
WA	6718	Roebourne, Whim Creek	4 596
WA	6722	South Hedland, Pippingarra, De Grey, Finucane	4 483
WA	6726	Broome	4 248
Qld	4875	Torres Strait	4 224
Northern Australia			**2 443**
Rest of Australia			**1 337**

Source: ACCC analysis of data obtained from insurers.

Note: Postcodes with fewer than 20 policies supplied have not been included.

Table 3.8 lists the postcodes with the highest premiums per sum insured ratios throughout Australia. These ratios are between three to nearly five times the average premium per sum insured for the southern part of Australia.

Table 3.8: Highest premium per sum insured areas, 2017–18

Region	Postcode	Areas included in postcode	Premium per $1000 sum insured
WA	6718	Roebourne, Whim Creek	$11.32
WA	6710	Cane, Onslow, Peedamulla, Yannarie	$9.05
WA	6713	Dampier, Damier Archipelago	$8.22
WA	6720	Cossack, Point Sason	$8.20
Qld	4809	Shirbourne, Jerona, Barratta, Giru	$8.10
WA	6722	South Hedland, Pippingarra, De Grey, Finucane	$7.92
WA	6721	Port Hedland, Indee, Mundabullangana, Wallareenya	$7.69
Qld	4806	Arkendeith, Carstairs, Osborne, Wangaratta	$7.52
Qld	4808	Brandon, Colevale	$7.40
WA	6707	Exmouth, Learmonth, North West Cape, Exmouth Gulf	$7.02
Northern Australia			**$4.34**
Rest of Australia			**$2.17**

Source: ACCC analysis of data obtained from insurers.

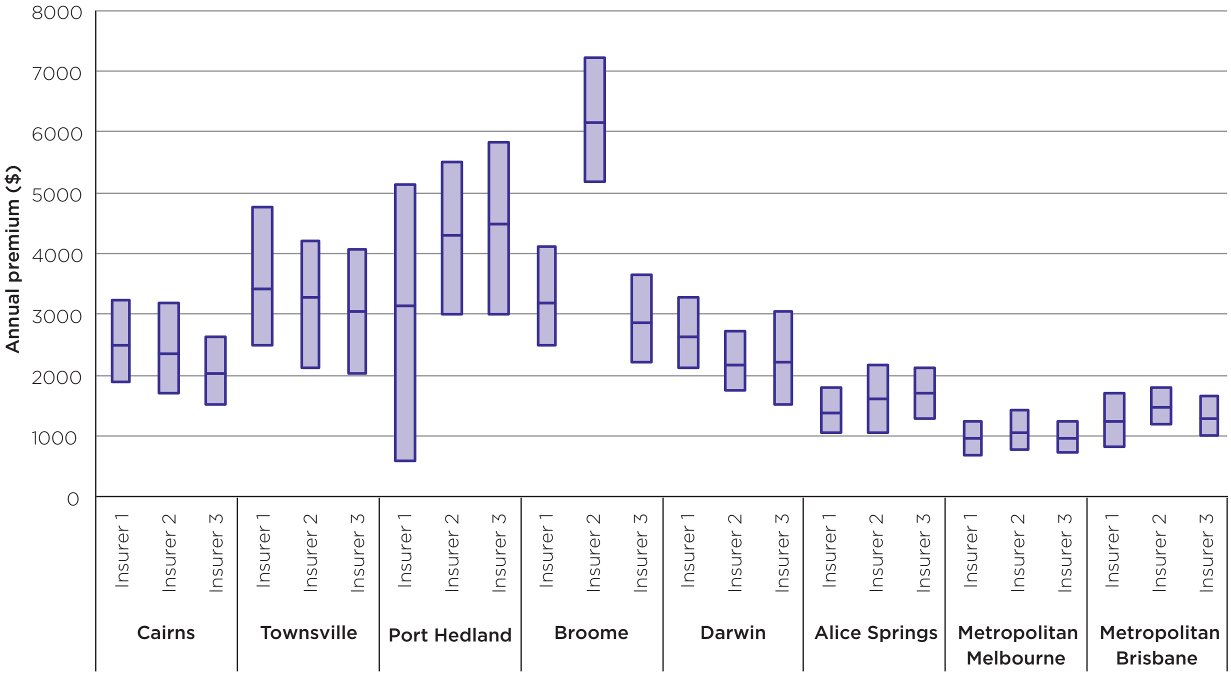
Note: Postcodes with fewer than 20 policies supplied have not been included.

Seven of the postcode areas with the highest average premiums paid (6710, 6713, 6720, 6721, 6707, 6718, and 6722), also feature in the regions with the highest premium per sum insured.

Premium distribution in northern Australia

In addition to looking at average premiums paid and premiums per sum insured ratios, we have also looked at the distribution of premiums paid for home and contents insurance products in parts of northern Australia and the rest of Australia. Figure 3.13 shows a sample of the lower quartile, median and upper quartile of premiums provided by a sample of insurers in metropolitan Brisbane and Melbourne and selected centres in northern Australia.

Figure 3.13: Lower quartile, median and upper quartile of annual premiums (2017–18)



Source: ACCC analysis of data obtained from insurers.

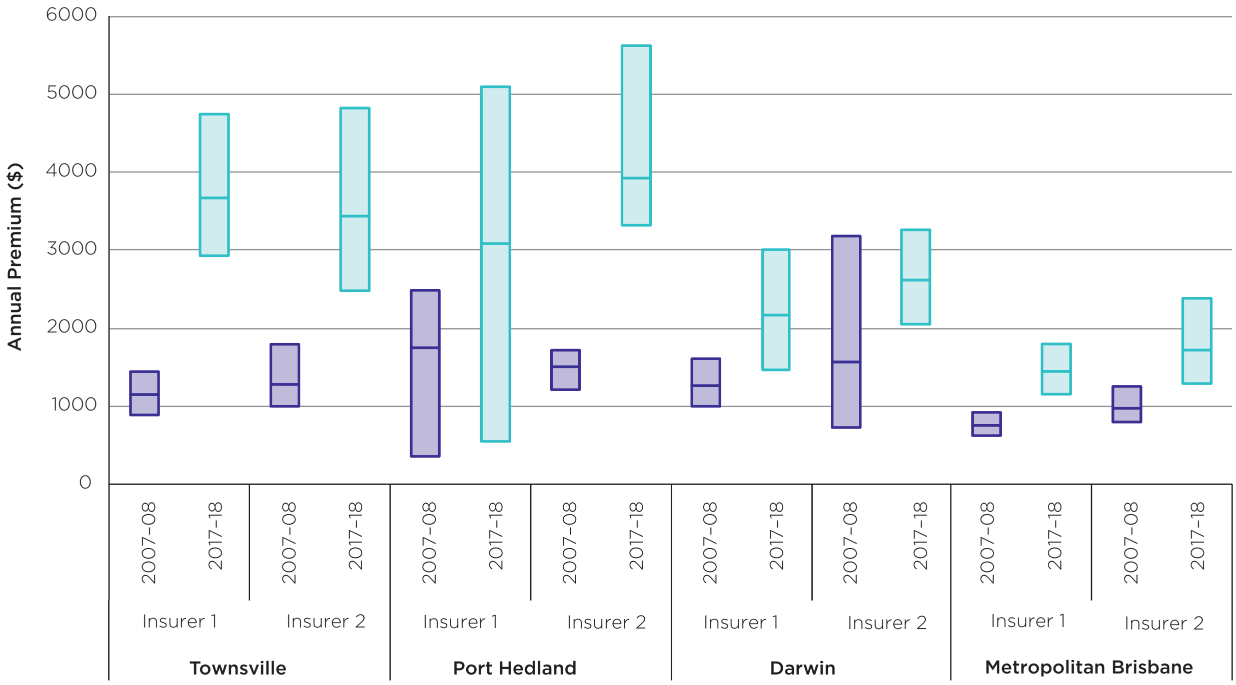
Note: The lower end of the bars represents the lower quartile, the dividing line the median, and the top of the bar the upper quartile. Insurers may differ between regions.

The figure shows that in some regions, the premiums paid by many consumers in northern Australia can be much higher than average figures alone indicate, and also that the distribution of premiums in northern Australia is generally wider than for the rest of Australia. Further, it indicates that there are more consumers paying very high premiums in these areas. For example, in Townsville, Port Hedland, and Broome the upper quartile for nearly all the sampled insurers is over $4000.

While this is only a selection of areas in northern Australia, we have found that the average of median and upper quartiles is higher across northern Australia than it is in the rest of Australia. This suggests that the above trends are likely to be seen in many parts of northern Australia. We will further consider the distribution of premiums within parts of northern Australia as part of focus area 2 outlined below.

Further, the spread of premiums has also increased over the period to a significant extent in northern Australia. This is illustrated below in figure 3.14 which shows the range of premiums for combined home and contents insurance, from a selection of insurers, in a selection of regions in 2007–08 and 2017–18.

Figure 3.14: Lower quartile, median and upper quartile of annual premiums for combined home and contents insurance, 2007–08 and 2017–18, real $2017–18



Source: ACCC analysis of data obtained from insurers.

Note: The lower end of the bars represents the lower quartile, the dividing line the median, and the top of the bar the upper quartile. Insurers may differ between regions.

This illustrates that the quartiles and the median have increased substantially in these areas, but the difference between the lower quartile and upper quartile have also increased. This may be a result of a move to more granular pricing by insurers during the period.

As discussed in detail in chapter 5, over the last 11 years (particularly following 2010–11) insurers' pricing methodologies have become more granular, and insurers have been better able to accurately assess risk. This has seen premiums for high risk properties increase, and diverge from premiums for lower risk. This change has had less impact in lower risk properties. This change in methodology explains, at least in part, the change in the spread of premiums observed in figure 3.14 above.

We also note that while the above figure also shows trends for a selection of regions and insurers, we observed similar trends in a number of regions and insurers in northern Australia, and metropolitan centres.

Areas of northern Australia with lower premiums

In contrast to the high priced postcodes outlined above, some postcodes in northern Australia have lower average premiums paid for home and contents insurance. However, there are only a small number of areas where average premiums paid are lower than the average for the rest of Australia, as shown in the maps in figures 3.11 and 3.12 above.

Of the 193 postcodes areas in northern Australia, only seven post code areas had an average premium for combined home and contents insurance that was below the average for the rest of Australia (approximately $1300 per annum).

This does not appear to be a result of higher than average sums insured in northern Australia, as only 10 areas have a lower premium per sum insured ratio than the ratio for southern Queensland (excluding Brisbane), which is the region outside of northern Australia with the highest premium per sum insured.

The average price of home and contents insurance in even the most affordable parts of northern Australia is higher than average prices in most other parts of the country.

High premium areas outside of northern Australia

As noted above, there are a number of areas outside of northern Australia where premiums, and premiums per sum insured are also high. These are generally areas which face higher catastrophe risks.

In the North West region of New South Wales, properties situated roughly between Rowena, North Star, and Wee Waa can have average premiums comparable to those situated in the highest risk regions of northern Australia. Average premiums in this region are generally comparable to the average premium for northern Australia but in certain areas, such as Rowena, the average premium exceeds $6000 (or around $9 per $1000 sum insured). These are regional areas, and properties in these regions may be prone to flooding.

Home and contents insurance in the Gold Coast and Sunshine Coast in Queensland represent a large proportion of high priced premiums outside of northern Australia. Average premiums here range between around $1700 and $2100, and affect at least 25 000 householders. Although slightly below the average premium for northern Australia, the average premium in the area is still nearly double the rest of Australia. This region is also exposed to a range of catastrophe risks: it is susceptible to damage from cyclones and also has a history of severe flooding, storms and bushfires.

Regions in South Australia, such as Cherryville and Crafers (suburbs close by Adelaide) border on parkland or national reserve, and also face higher than average premiums, of around $1500. It appear that a number of properties in these areas have higher bush fire risk and this means the area faces some of the highest premiums in South Australia. The data indicates these regions generally pay around $1500 in premiums annually.

3.3 Strata insurance premiums

The insurers also provided us with detailed information about pricing of strata insurance.

Under state and territory legislation the body corporate, or owners' corporation must purchase strata insurance to cover the estimated total cost of replacing the common property of the strata scheme.[39] The type of property covered by strata insurance will depend on the nature of the strata property. For example, for a multi-level apartment block, most of the building will be covered by the strata policy. Whereas, for a strata complex with a number of free standing properties the property covered may be more limited, such as common driveways or gardens. Strata insurance does not provide coverage for residents' contents and residents of strata complexes generally hold their own separate contents insurance.

The premiums reported in this section are for entire strata complexes and do not take into account the size of the complex or the number of dwellings covered (i.e. we have not reported strata premiums on a per dwelling or per unit basis). This means that there can be wide variations in average annual premiums for strata policies, depending on the type and size of strata title property insured in the relevant area. However, examining premiums per sum insured helps us take the difference in the size of properties into account. As with home and contents insurance, sums insured in northern Australia can be higher than in the rest of Australia for a complex of a comparable size/number of units due to higher building and construction costs in northern Australia.

In our *Update report* we observed that strata insurance premiums in northern Australia were higher than in the rest of Australia, and that they had increased substantially in northern Australia since 2007–08. This section of the paper provides updated and more detailed analysis of strata insurance premium trends in northern Australia.

The data described below does not include TIO figures prior to the 2015–16 financial year.

39 Chapter 8 summarises the legislative requirements applicable in Western Australia, Northern Territory and Queensland.

Stakeholder views and previous reports

As for home and contents insurance, previous inquiries have also commented on premiums for strata insurance in northern Australia. The Australian Government Actuary has previously found that on average:

- between 2007 and 2012 strata insurance premiums in north Queensland had increased by over 300 per cent[40]
- between 2009–10 and 2012–13 strata insurance premiums in Darwin increased by 60 per cent.[41]

A number of submissions to our inquiry from strata groups and consumers expressed concerns about strata premiums in northern Australia. To inform its submission to the inquiry, Strata Community Association Qld (SCAQ) surveyed its members about their experiences. Members' responses described the very high cost of insurance, which greatly impacts on the affordability of owning a unit, particularly as an investor. Some owners can no longer afford levies and have sold their unit. One described their experience with an insurer as 'price gouging'. SCAQ also said a lot of bodies corporate now obtain premium funding.[42]

Ms Margaret Shaw has actively participated in public consultation about the cost of insurance for strata buildings in Queensland and advocates for reform on behalf of strata property owners. In her submission to our inquiry, Ms Shaw indicated her own apartment complex received an increase of over 300 per cent in 2011 with no claims, an increase of over $50 000 which had not been budgeted for and for which a loan had to be sought.[43]

We also received a number of submissions from individual property owners who discussed the difficulties their body corporate (or a broker acting for the body corporate), had encountered in trying to find an insurer to even provide a quote. Ms Shaw submitted that people had been without insurance in breach of their legal requirement due to not being able to find an insurer.

Current strata insurance premiums

In 2017–18 average strata insurance premiums, and premium per sum insured ratios were considerably higher in northern Australia than the rest of Australia.

The average premium paid in northern Australia was $6370 per annum, double the average for the rest of Australia of $3150. Average premiums were highest in north Western Australia, at $15 400 per year, almost five times the average for the rest of Australia. Premiums in north Queensland were approximately $6100 per annum, and $6500 in the Northern Territory.

Strata insurance was approximately $3.48 per $1000 sum insured in north Western Australia, about 3.8 times the average of $0.91 per $1000 insured in the rest of Australia. North Queensland was 2.6 times the average for the rest of Australia, at $2.39 per $1000 insured, and the Northern Territory 1.7 times the average at $1.58 per $1000 insured. These results are shown below in figure 3.15.

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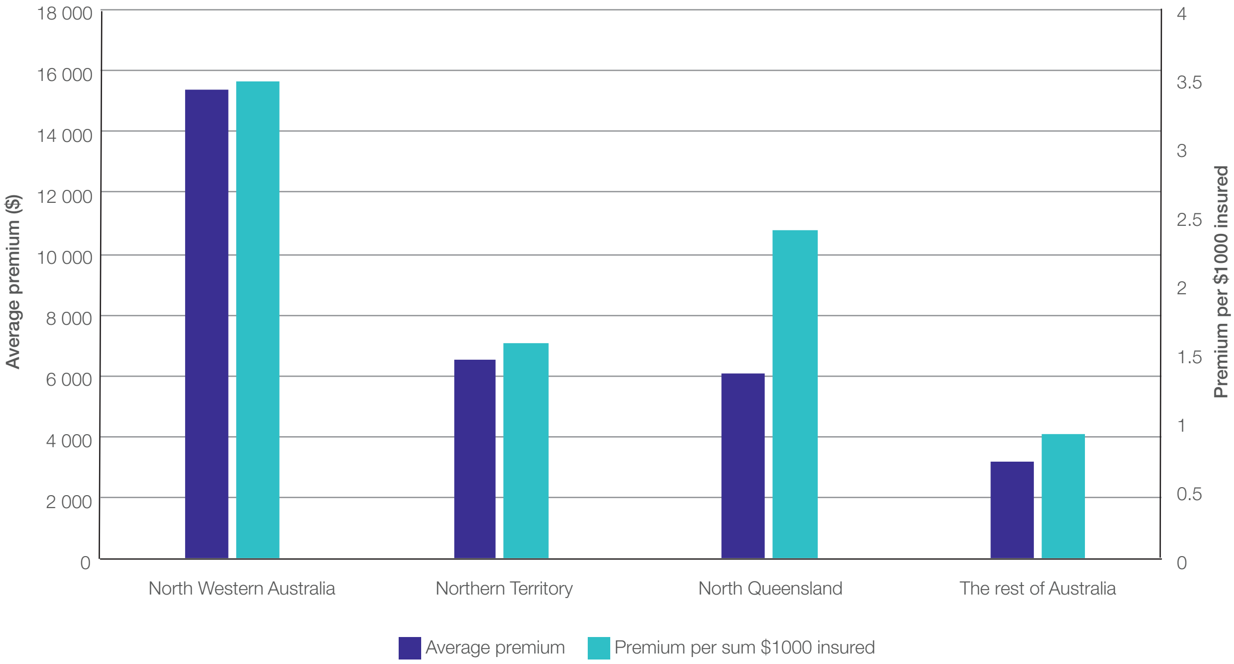
40 Australian Government Actuary, *Report on investigations into strata title insurance price rises in north Queensland*, October 2012, p. 4. These observations were based on premium per sum insured data using data voluntarily provided by three insurers: CGU, Suncorp and Zurich.

41 Australian Government Actuary, *Second report on strata title insurance price rises in north Queensland*, June 2014, p. 22, 23. This was based on data provided voluntarily by six insurers: the Territory Insurance Office, QBE, Allianz, CGU, Suncorp and Zurich.

42 Strata Community Association Qld, Submission, 19 January 2018, p. 4.

43 Shaw, Margaret, Response to ACCC issues paper, 25 October 2018.

Figure 3.15: Average annual premiums and premium per $1000 insured for strata insurance, 2017–18



Source: ACCC analysis of information obtained from insurers.

In 2017–18, the average excess levels in northern Australia were much higher than in the rest of Australia, as shown in table 3.9 below. If excess levels similar to those elsewhere in Australia were selected by consumers in northern Australia, the difference in average premiums between these areas would be even larger. Table 3.9 also shows that excess levels have increased considerably over the ten year period in all regions, but that the change has been largest in northern Australia. This may partly be a result strata communities increasing excess levels as way to deal with increasing premiums for strata insurance.

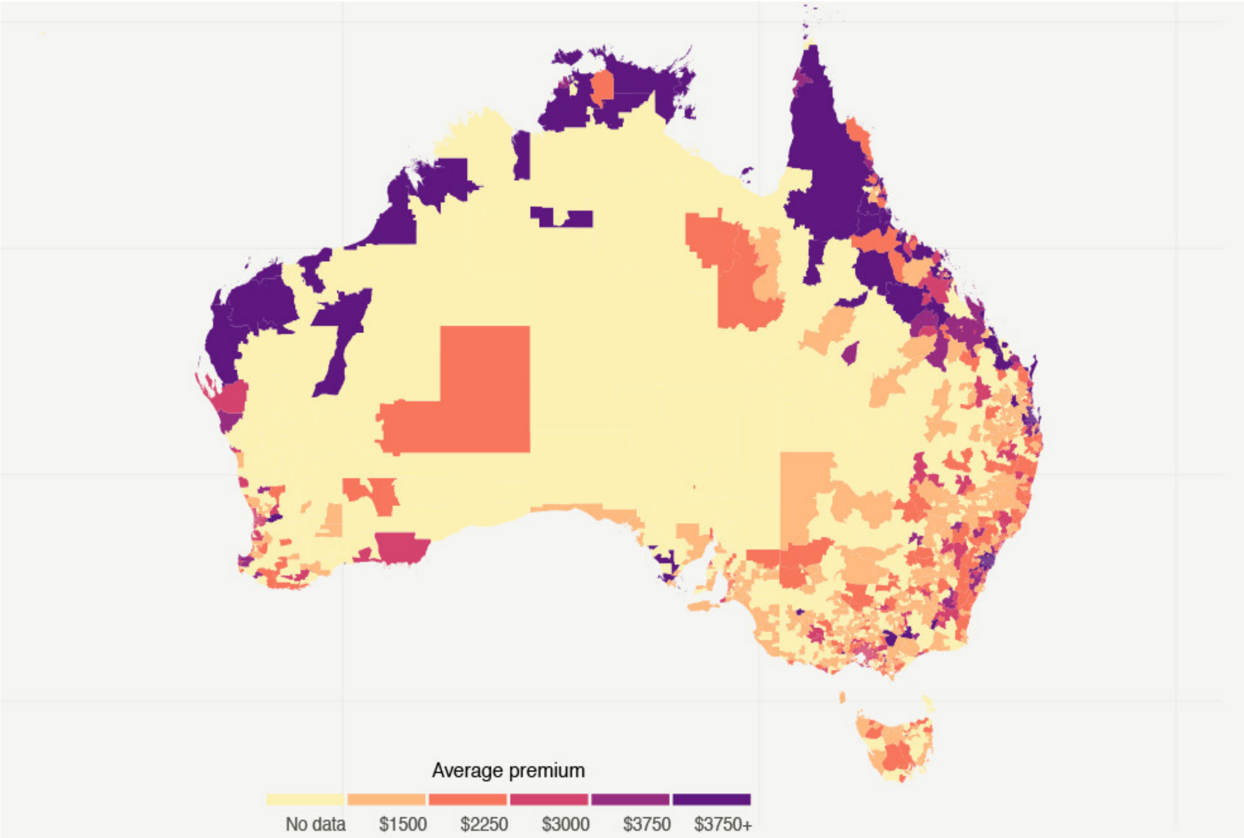
Table 3.9: Average excess levels for strata insurance between 2007–08 and 2017–18, real $2017–18

Region	Average excess 2007–08 ($)	Average excess 2017–18 ($)	Percentage increase (%)
North Western Australia	170	1000	480
Northern Territory	160	590	280
North Queensland	62	670	990
The rest of Australia	92	250	170

Source: ACCC analysis of information obtained from insurers.

As for home and contents insurance, there is variation in premiums across northern Australia. Figures 3.16 and 3.17 show average premiums and premiums per sum insured across Australia.

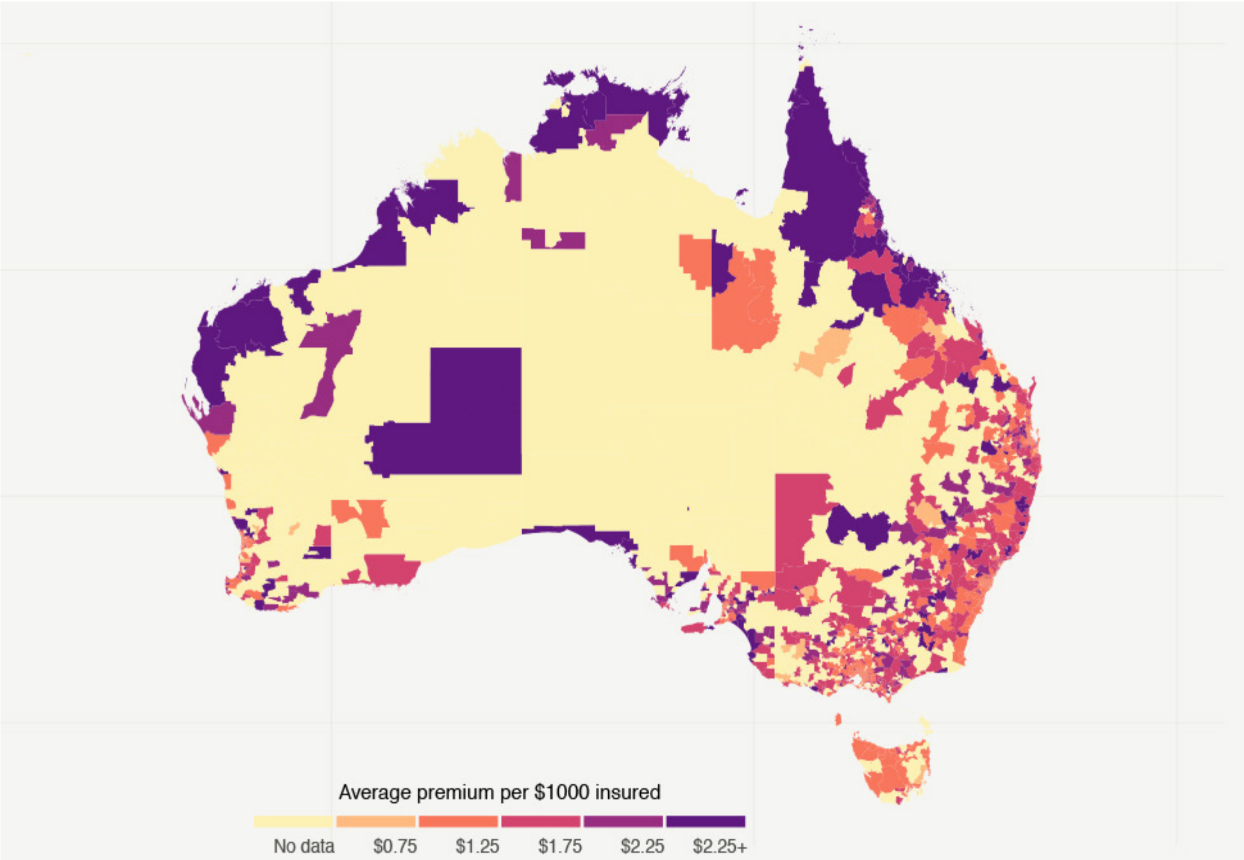
Figure 3.16: Average premiums for strata insurance in Australia, 2017–18



Source: ACCC analysis of data obtained from insurers.

The above shows clearly that strata premiums across many postcodes in northern Australia are on average higher than in the rest of Australia, but there are also small areas outside of northern Australia where average premiums are also high. However, it also shows that there are few strata insurance policies across large areas of Australia, which is not unexpected given they are in regional areas.

Figure 3.17: Premiums per sum insured for strata insurance in Australia, 2017–18



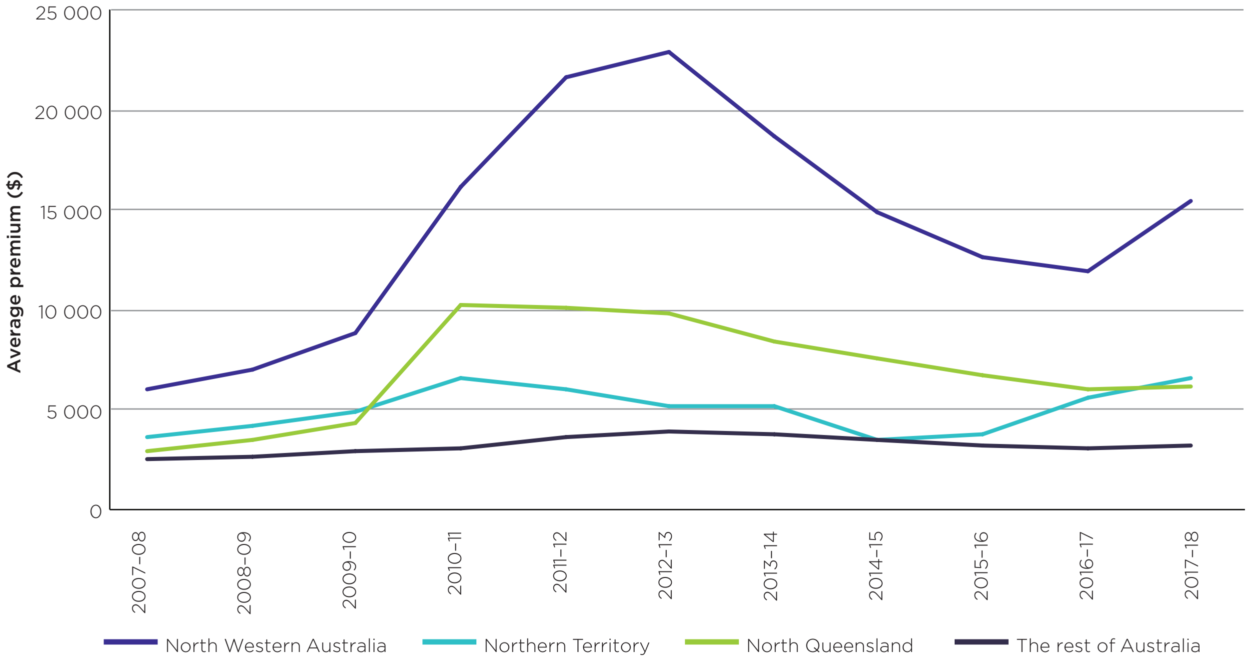
Source: ACCC analysis of data obtained from insurers.

Similarly figure 3.17 also shows that premiums per sum insured are very higher (at over $2.2 per $1000 insured) across a large part of northern Australia.

Strata premiums over time

Over the last ten years, strata insurance premiums have increased quite dramatically, but have generally been falling in more recent years. Despite falling they were still considerably higher in 2017–18 than they were in 2007–08.

Figure 3.18: Average premiums paid for strata insurance products, 2007–08 to 2017–18, real $2017–18



Source: ACCC analysis of data obtained from insurers.

Note: Trends for the Northern Territory do not include data for the TIO prior to 2015–16

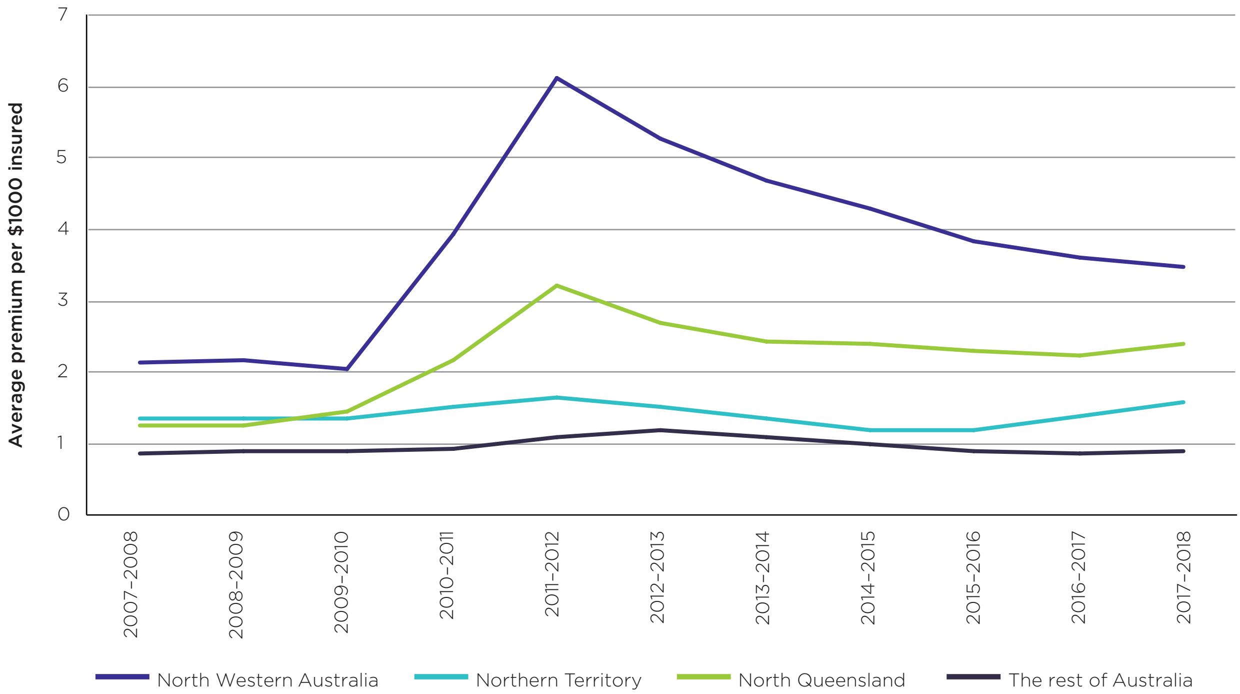
Figure 3.18 shows that average premiums increased significantly in north Western Australia between 2007–08 and 2012–13, but are lower today than at their peak. Overall, premiums in 2017–18 are 159 per cent higher than they were in 2007–08. However, there are only a small number of strata policies in north Western Australia, with an average of 185 policies over the eleven years. The small sample size makes it more difficult to reach robust conclusions about trends in north Western Australia.

Average premiums in north Queensland peaked in 2010–11, increasing by about 254 per cent since 2007–08. However, they have fallen on average by seven per cent every year since then. They are still 113 per cent higher in 2017–18 than they were in 2007–08. Premiums in the Northern Territory have varied over the period, but they have recently been increasing. Over the 10 year period they have increased by 82 per cent.

Average premiums for strata insurance in the rest of Australia have been quite stable in comparison to northern Australian premiums. Between 2007–08 and 2017–18 premiums have increased by only 26 per cent.

When changes in sum insured are considered, the trends are less volatile, although there have still be considerable increases in north Queensland and north Western Australia. Premiums per sum insured in north Western Australia peaked in 2011–12, but have fallen since this time but remain 61 per cent higher than they were in 2007–08. In north Queensland premiums per sum insured peaked in 2011–12, but again they have fallen since then, and have remained flat over the past few years at 92 per cent higher than they were in 2007–08. In contrast, premiums per sum insured have not changed substantially over the same period in the rest of Australia or the Northern Territory. These trends are illustrated in figure 3.19.

Figure 3.19: Premiums per sum insured for strata insurance products, 2007–08 to 2017–18



Source: ACCC analysis of data obtained from insurers.

Note: Trends for the Northern Territory do not include data for the TIO prior to 2015–16.

We note that for both average premiums, and premiums per sum insured, the observations for the Northern Territory do not include data for the TIO prior to its acquisition in 2015. We understand that the TIO had a significant share of strata market. This means that actual trends prior to 2015 for the Northern Territory may differ from what is indicated above.

3.4 Summary of pricing in northern Australia

The analysis in this chapter confirms that, no matter how measured, the cost of home and contents insurance is higher for those living in northern Australia, and these costs have become higher over time. The issue is most pronounced for Western Australia, but is still significant in north Queensland and the Northern Territory. Affordability of insurance is also a more significant issue for building insurance than contents insurance.

Strata insurance is also considerably more expensive in northern Australia than it is in the rest of the country, both in terms of average premiums and premiums per sum insured. However, while average premiums have increased quite significantly, this in part reflects a rise in the average sums insured for strata properties, and when premiums per sum insured are considered, particularly in north Queensland and north Western Australia, the increases are not as dramatic.

Importantly, for across many of the products and regions, there are indications the rate of premium increases is slowing, and in some cases average premiums may even be decreasing. However, this may be in part due to higher-risk properties dropping out of insurance markets altogether in response to high premiums, and may not fully reflect an overall improvement in affordability.

We are aware that the analysis in this chapter does not necessarily reflect the experience of all local residents and property owners in northern Australia. Within postcodes there will be insurance premiums that are considerably higher (and lower) than the average for the area. We propose to undertake more detailed analysis of premiums for home, contents and strata insurance in a number of regions in 2019 to gain a better understanding of where consumers face acute challenges in the availability of affordable insurance products.

Focus area 2: Detailed case studies on sub-regions in northern Australia

We will undertake a number of detailed case studies on parts of northern Australia that face particularly acute availability or affordability issues. In addition to looking more closely at premium pricing in the area, we will also consider other issues such as claims experience, levels of non-insurance and underinsurance, and the degree of competition in the area.

4. The costs of providing insurance

Key points

- Northern Australia represents 11 per cent of national gross claims expense for all home and contents insurance since 2007–08, despite only representing 5 per cent of the policies.
- Insurer costs are higher in northern Australia, primarily due to the frequency and severity of catastrophe claims experienced, and the higher associated allocation of reinsurance costs.
- When you set aside the cost of natural catastrophes, on a real per product basis, gross claims expenses have remained relatively steady across Australia, with no noticeable difference between northern Australia and the rest of Australia.
- On average, claims are more frequent and larger in northern Australia compared to the rest of the country, although there is considerable variation from year to year. Strata claims in northern Australia are on average three times larger than those made in the rest of Australia.
- Insurers increased their expenditure on reinsurance following large claims in 2010–11. This is a consequence of reinsurance rates increasing in response to large global losses that year. Since then, reinsurance expenditure has remained steady.
- Commission costs in northern Australia have more than doubled on a real per product basis since 2007–08. This is to be expected due to most commission costs being determined as a proportion of (rising) premiums.
- On a per product basis, underwriting costs are higher in northern Australia than the rest of Australia. Underwriting costs per product are currently decreasing across Australia.

This chapter outlines the key cost categories for insurers supplying home, contents and strata insurance products. We examine the relative size of these costs in northern Australia and trends over time.

4.1 Categories of insurer costs

The costs insurers incur in supplying insurance products can be divided into the following categories:

- **Claims costs**—This includes costs such as the claims incurred and the cost of handling and assessing claims. These costs tend to vary with the number of policies written and the relative risk of to the property insured. 'Gross claims expense' is a commonly used measure of claims costs. It includes all costs incurred in responding to claims, without taking into account reinsurance and non-reinsurance recoveries. The difference between gross claims expense and 'net claims expense' is the amount of reinsurance and non-reinsurance recoveries.

  Across all home, contents and strata insurance products, net claims expense averaged around 55 per cent of insurer costs in northern Australia in 2017–18. This figure has been calculated using net rather than gross claims expenses.

- **Reinsurance costs**—This includes the cost of premiums paid to reinsurers. These costs tend to vary with the type of reinsurance purchased, the number of policies written, the sum insured of the policies written and the relative risk of the properties insured.

  Across all home, contents and strata insurance products, this cost category averaged around 31 per cent of insurer costs in northern Australia in 2017–18.

- **Underwriting costs**—This includes levies, charges, and acquisition costs which are incurred in obtaining and recording insurance contracts. They include selling and underwriting costs such as advertising and risk assessment, the administrative costs of recording policy information and premium collection costs. This is determined in accordance with AASB 1023. Commission costs are usually considered an underwriting cost, but for the purpose of this report we have separately identified these below. Underwriting costs tend to vary with the number of policies written.

  Across all home, contents and strata insurance products, this cost category averaged around 7 per cent of insurer costs in northern Australia in 2017–18.

- **Commission costs**—This includes the costs of commission or brokerage paid to an intermediary for obtaining business for the insurer. These costs tend to vary with the number of policies written and in proportion to gross written premium.

  Across all home, contents and strata insurance products, this cost category averaged around 7 per cent of insurer costs in northern Australia in 2017–18.

These cost categories are considered in turn below.

4.2 Gross claims expense for all home and contents products

Gross claims expense includes all costs incurred in responding to claims, without taking into account reinsurance and non-reinsurance recoveries. Reinsurance costs and recoveries are considered in section 4.5.

Gross claims expense for all home and contents products in northern Australia over the past eleven years comes to $4.1 billion, 11 per cent of the national total, although this proportion varies considerably from year to year. In 2010–11, northern Australia made up 24 per cent of national gross claims expenses (compared to eight per cent of gross written premium), but this fell as low as four per cent in 2015–16 (compared to 10 per cent of gross written premium).[44] The gross claims expense for all home and contents insurance in northern Australia and the rest of Australia is illustrated in figure 4.1 below.

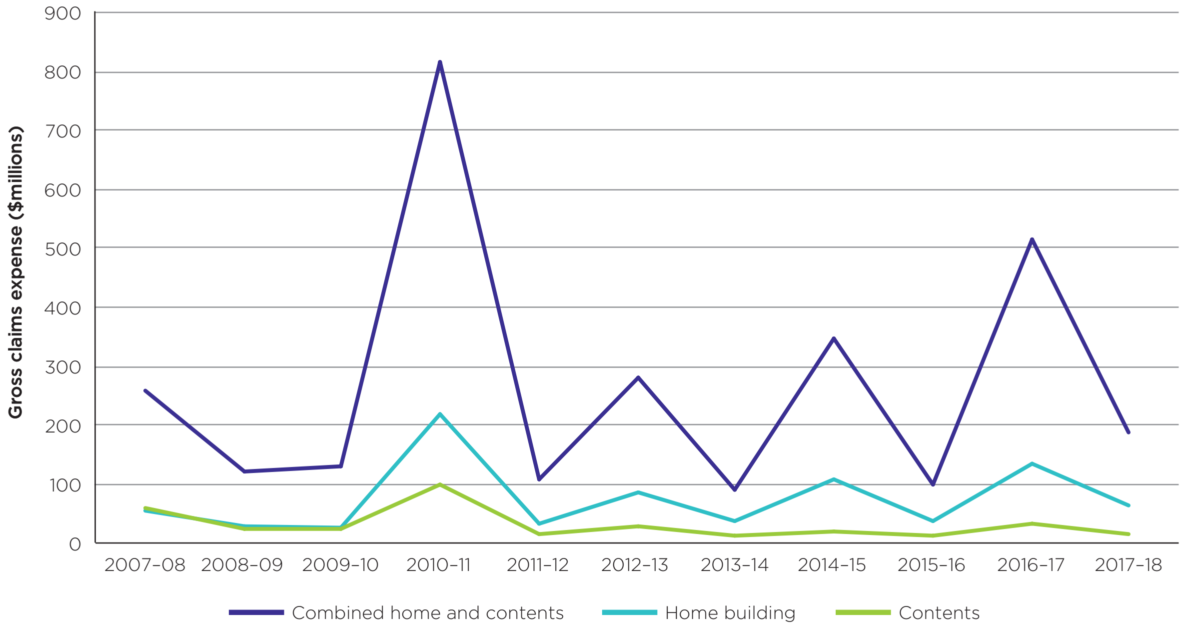
Figure 4.1: Gross claims expense for all home and contents products, 2007–08 to 2017–18, real $2017–18

Source: ACCC analysis of data obtained from insurers.

Gross claims expense in northern Australia differs considerably from year to year; home insurance and combined home and contents insurance products are extremely volatile, while contents insurance is more consistent. Figure 4.2 shows the gross claims expense for each product across northern Australia.

44 Gross written premium excludes GST, levies and stamp duty.

Figure 4.2: Northern Australian gross claims expense, 2007–08 to 2017–18, real $2017–18



Source: ACCC analysis of data obtained from insurers.

The primary driver of the high variability in overall gross claims expense in northern Australia is natural catastrophes. Natural catastrophes have a higher impact on gross claims expense for home and combined home and contents insurance products due to the potential for widespread significant damage to buildings, with losses up to and including the full sum insured value. The maximum size of a loss for contents insurance is limited by the overall lower level of sum insured for contents policies.

Some of the most costly natural catastrophes to impact Australia have been cyclones. Table 4.1 shows the most expensive cyclones by gross claims expense to impact northern Australia in the last eleven years. It includes commercial losses as well as residential losses.

Table 4.1: High cost cyclones in Australia, 2007–08 to 2017–18, real $2017–18

Event	Region	Year	Gross claims expense (millions)
Cyclone Debbie	QLD	2016–17	$1598
Cyclone Marcia	QLD	2014–15	$572
Cyclone Oswald	QLD	2012–13	$1188
Cyclone Yasi	QLD	2010–11	$1610
Cyclone Tasha	QLD	2010–11	$413

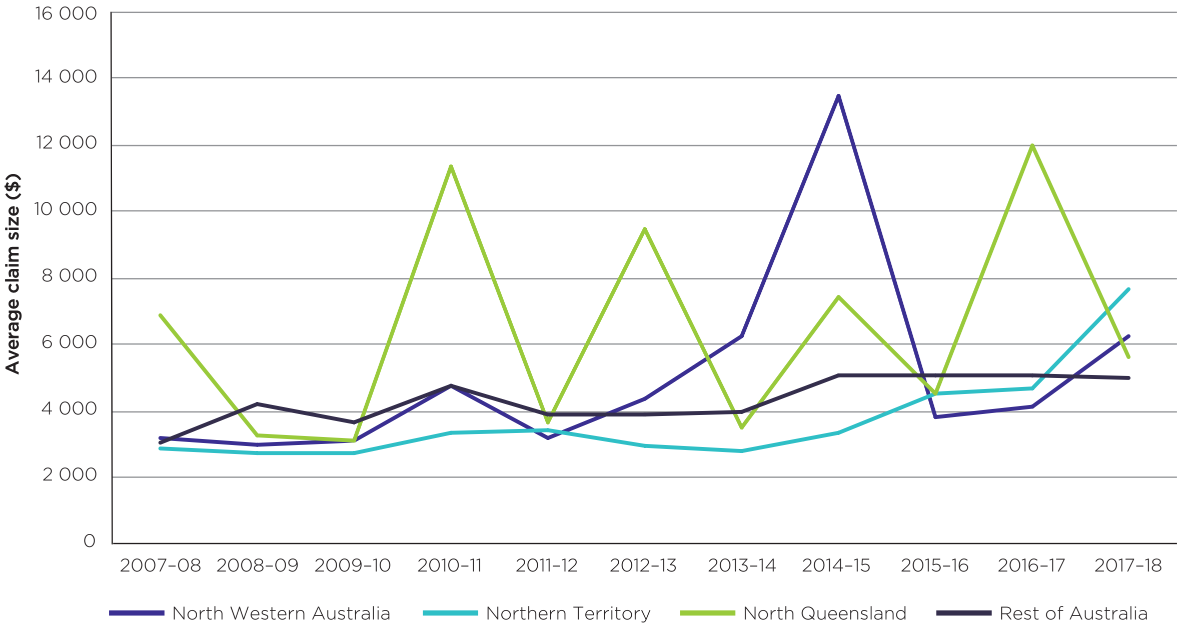
Source: Insurance Council of Australia media release '$1 BILLION PAID IN CYCLONE DEBBIE INSURANCE CLAIMS' dated 6 November 2017. Figures updated to real $2017–18 by ACCC.

Size of claims

On average, the size of individual claims in northern Australia is generally higher than in the rest of Australia. For example, the overall average cost of all claims under home and/or contents products in north Queensland over the eleven year period was $7090, in the north of Western Australia it was $5900 and in the Northern Territory it was $4570. In the rest of Australia the average claim size was just $4310.

The Northern Territory consistently had one of the smallest average claim sizes for each product type, with high claims in 2017–18 raising the overall Northern Territory average considerably. This can be compared to average claims sizes in north Queensland and north Western Australia which are extremely volatile from year to year due to the cost of natural catastrophes. The average size of a claim over the last eleven years is shown in Figure 4.3 below.

Figure 4.3: Average claim size, 2007–08 to 2017–18, real $2017–18



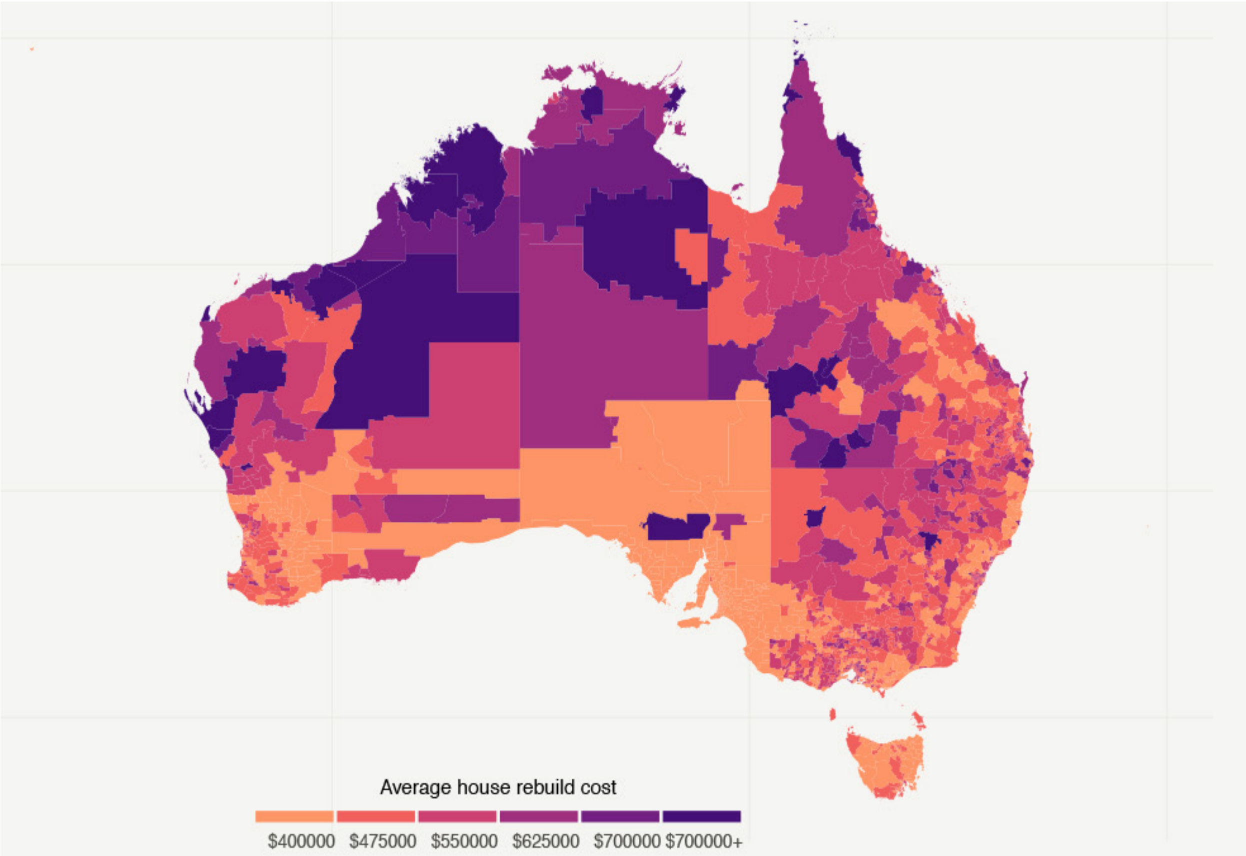
Source: ACCC analysis of data obtained from insurers.

The overall increasing trend in average claim size across Australia can partly be attributed to a steady increase in the average excess levels, which reduces the incidence of low value claims.

The relatively higher cost of claims in northern Australia can be explained in part with reference to the higher building and repair costs compared to most other parts of Australia. These higher building costs are partly due to the smaller supply of materials and labour in northern Australia and partly due to the more stringent building standards imposed in cyclone risk regions.[45] High cost regions in the rest of Australia, such as southwest Queensland, are predominantly rural areas. Chapter 12 discusses building regulations further. Figure 4.4 below shows the average estimated cost of rebuilding a home around Australia. In addition to showing high cost regions of northern Australia, figure 4.4 also shows some high rebuilding cost areas outside of northern Australia, such as southwest Queensland. These areas are predominantly rural or regional areas that would also be subject to higher material transportation costs and/or labour supply constraints.

45 Suncorp submission p. 22.

Figure 4.4: Average estimated home rebuilding cost by postcode, nominal $2017



Source: ACCC analysis of Geoscience Australia 2017 National Exposure Information System data.

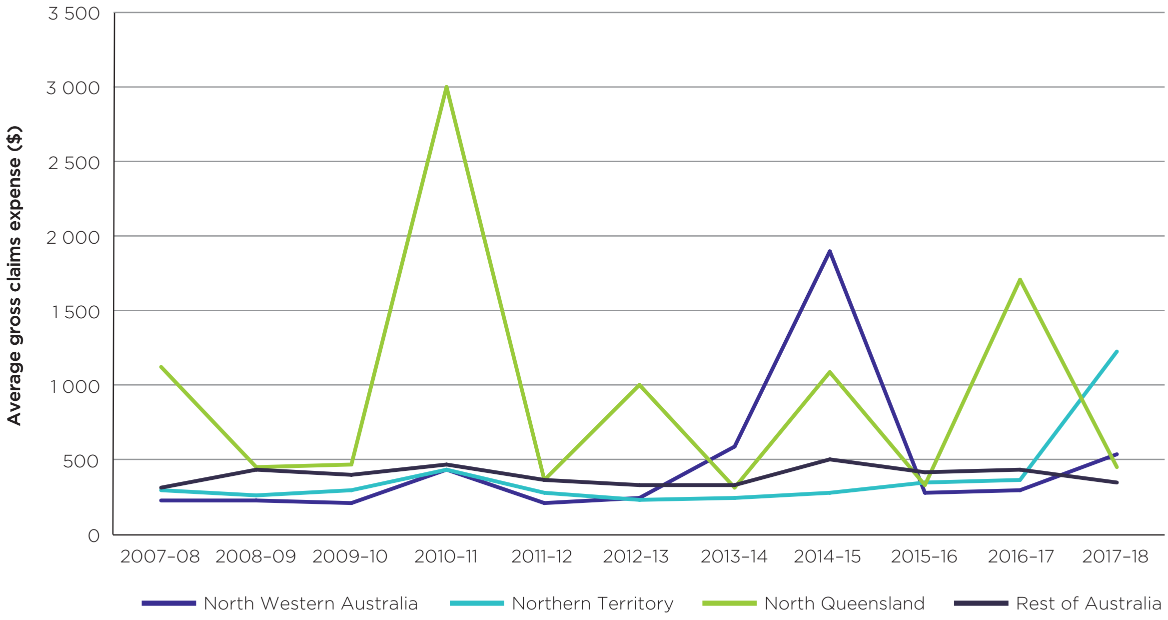
Gross claims expense per product

On average, the gross claims expense per home and/or contents insurance product has moved within the range of $200 and $600 across Australia with no general upward or downward trend. This is clearest in the rest of Australia, but is also apparent in northern Australia when years with high natural catastrophe claims are excluded.

In northern Australia, the gross claims expense per product is highly volatile due to catastrophe events.

North Queensland and north Western Australia have the widest range in average gross claims expense per product. North Western Australia's average in 2014–15 was almost quadruple their overall average due to Cyclone Olwyn's impact and the average being relatively easy to shift due to the overall low number of policies in the region. North Queensland was the most volatile with the average gross claims expense exceeding $1000 in five separate years, corresponding with the cyclones identified in table 4.1 and the Mackay floods in 2008. The Northern Territory has one of the lowest average gross claims expense per product most years, with 2017–18 being the main outlier with an average of over $870 more than the previous year. This increase can be attributed to Cyclone Marcus. These trends for all home and contents insurance products are shown in figure 4.5 below.

Figure 4.5: Average gross claims expense per product, all home and contents products, 2007–08 to 2017–18, real $2017–18



Source: ACCC analysis of data obtained from insurers.

Frequency of claims

On average, the proportion of all home and/or contents insurance products making a claim each year is notably higher in northern Australia (at 13 per cent) compared to the rest of Australia (nine per cent) over the eleven year period. The claims frequency in northern Australia is also more volatile than the rest of Australia. The year 2010–11 is again an outlier with a claims frequency of 26 per cent across all home and/or contents insurance products.

When considering the northern Australian subregions, the Northern Territory had the most stable claims frequency, although this was still more volatile than the rest of Australia. All three regions had one year that was over 50 per cent higher than their average frequency. These years correspond to the years with a cyclone impacting a population centre in the region. North Western Australia is the only region to have a consistently lower claims frequency than the rest of Australia, excluding the catastrophe year of 2014–15. The claims frequency for regional and metropolitan areas of the rest of Australia was almost identical most years, with no major deviations. The increasing trend in excess is reducing the number of small claims being made, and reducing the overall claims frequency, a similar effect to that observed for the average claim size. Figure 4.6 below shows these trends in claims frequency for all home and contents products over time.

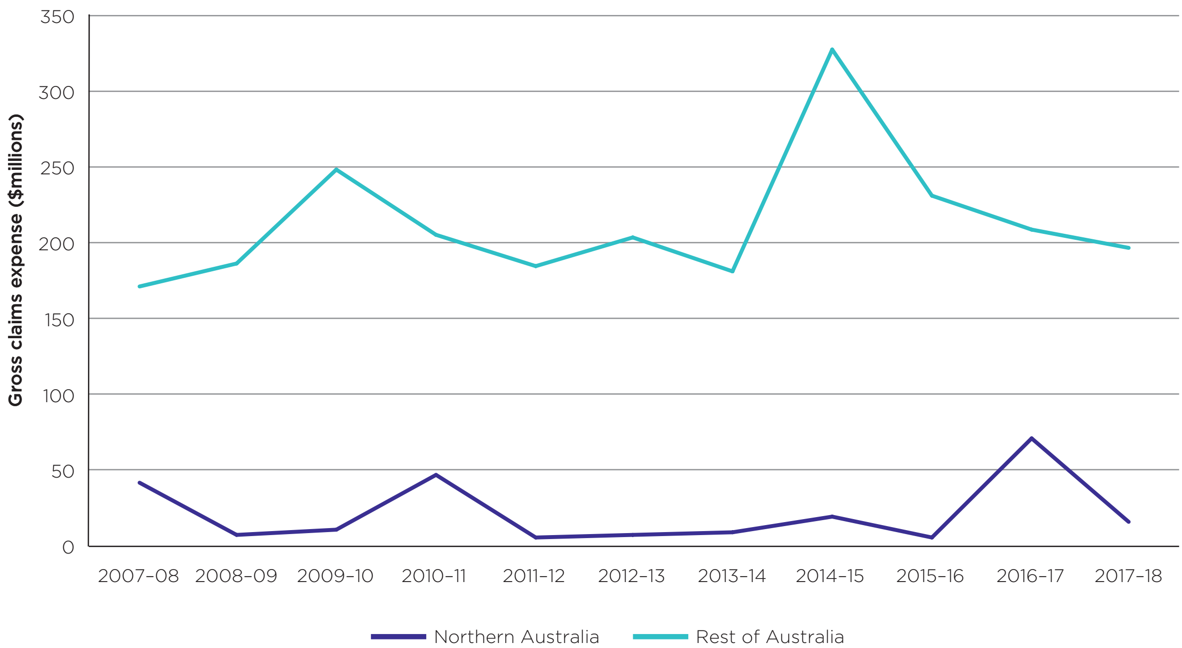
Figure 4.6: Average claim frequency all home and contents products, 2007–08 to 2017–18

Source: ACCC analysis of data obtained from insurers.

4.3 Gross claims expense for strata products

Gross claims expense for strata products in northern Australia over the past eleven years comes to $244 million, nine per cent of the national total, although this varies considerably from year to year. For example, in 2015–16, northern Australia made up just two per cent of national gross claims expenses (compared to eight per cent of gross written premium), but this rose as high as 25 per cent in 2016–17 (compared to nine per cent of gross written premium). The gross claims expense for strata insurance in northern Australia and the rest of Australia is illustrated in figure 4.7 below.

Figure 4.7: Gross claims expense for strata products, 2007–08 to 2017–18, real $2017–18



Source: ACCC analysis of data obtained from insurers.

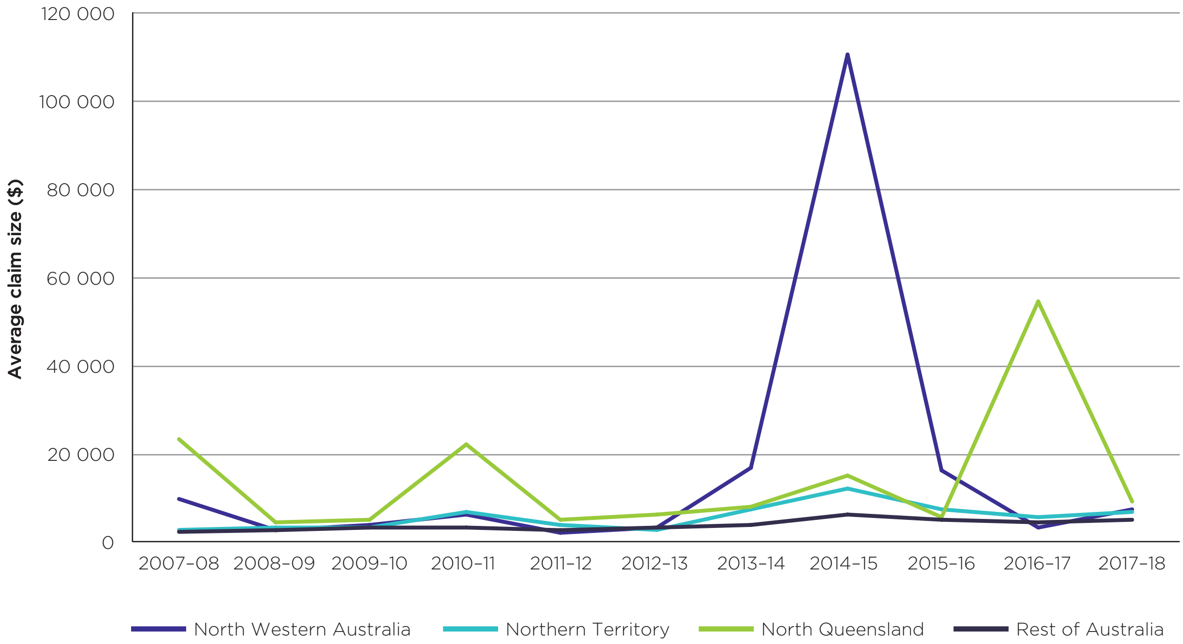
Similar to home and contents products, the gross claims expense of strata products is largely driven by natural catastrophes, with the largest contribution coming from the Mackay floods in 2007–08, Cyclone Yasi in 2010–11, and Cyclone Debbie in 2016–17. The impact of Cyclone Marcia in 2014–15 is also visible in figure 4.7 above, however the impact of Cyclone Oswald in 2012–13 is not apparent.

Size of claims

The average claim size for strata policies in northern Australia since 2007–08 was $13 400, the corresponding figure for the rest of Australia was just $3500. There has been a steady increase in the average claim size across Australia, this is most apparent in the rest of Australia where the data is not as affected by catastrophe claims. The average claim size in the rest of Australia has increased gradually from $2200 in 2007–08 to over $5000 in 2017–18. Similarly to home and contents products, this increase in the average claim size can partly be attributed to a steady increase in the average excess levels across Australia, reducing the incidence of low value claims.

Figure 4.8 below shows how the average claim size has changed over time.

Figure 4.8: Average claim size for strata products, 2007–08 to 2017–18, real $2017–18



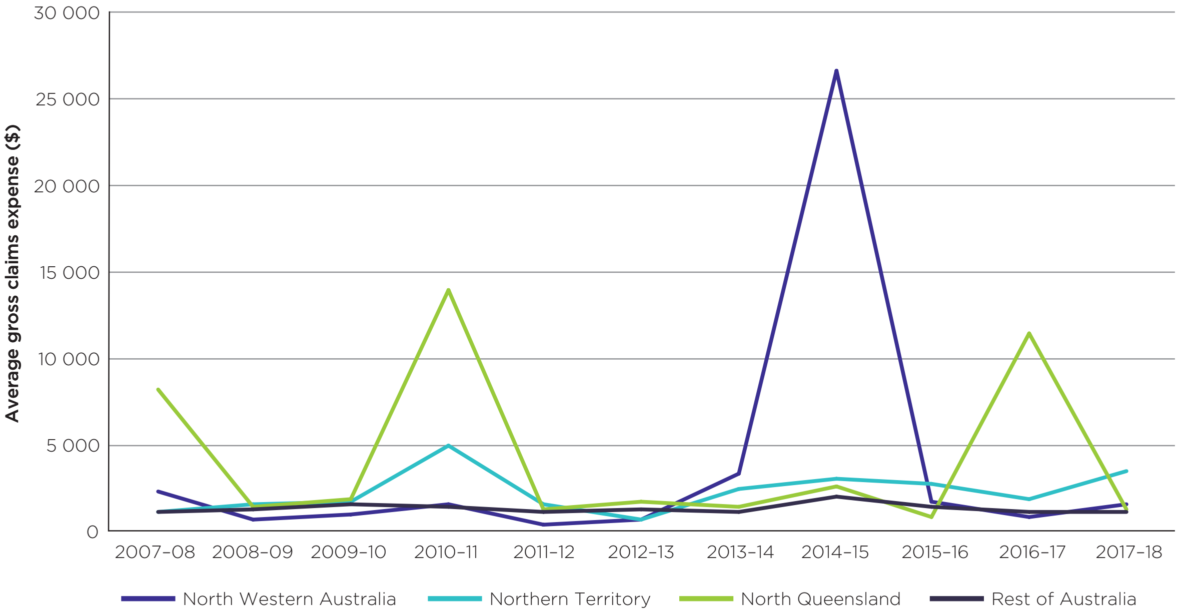
Source: ACCC analysis of data obtained from insurers.

The spikes in figure 4.8 correspond to years that each region suffered a catastrophe event. The very high average claim size in north Western Australia in 2014–15 can be attributed to a small number of very large claims associated with Cyclone Olwyn against a very low number of policies. As shown in figure 4.10, the claims frequency in north Western Australia was not unusually high that year.

Gross claims expense per product

The average gross claims expense per strata insurance product over the last eleven years was $3700 annually across northern Australia, compared to $1280 in the rest of Australia. Figure 4.9 below shows the annual breakdown of these figures over the period for each region. Natural disasters again were significant contributors to the average expenses, with the large spikes in north Queensland corresponding to the Mackay floods, Cyclone Yasi, and Cyclone Debbie. The spike in north Western Australia can again be attributed to Cyclone Olwyn.

Figure 4.9: Average gross claim expense per strata insurance product, 2007–08 to 2017–18, real $2017–18



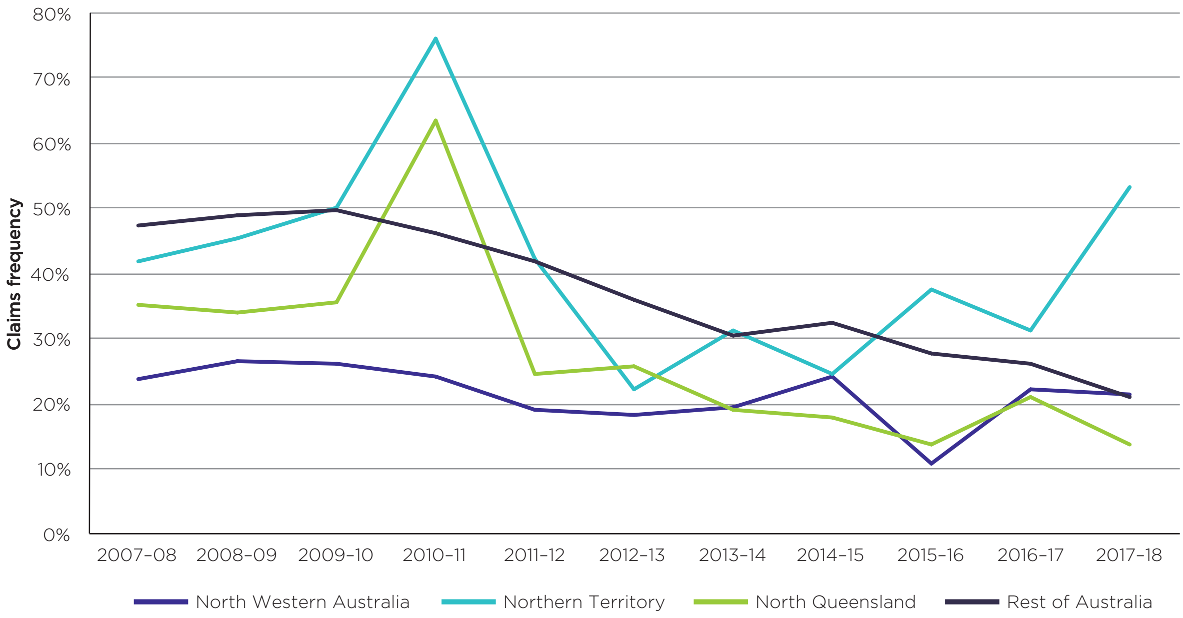
Source: ACCC analysis of data obtained from insurers.

Frequency of claims

The average claims frequency in northern Australia over the last 11 years is 28 per cent, this is considerably less than the average of the rest of Australia of 37 per cent. When considering the northern Australian subregions, the Northern Territory had the highest average claims frequency at 44 per cent, considerably higher than north Queensland's 26 per cent and more than double north Western Australia's 21 per cent.

Similarly to the average claim size, the steady decrease in claims frequency in the rest of Australia and north Queensland (when excluding the catastrophe year of 2010–11) can be partly attributed to the noticeable increase in the excess levels of strata policies across Australia. As the excess has increased, smaller incidents are no longer resulting in a claim and the overall claims frequency is dropping. In the Northern Territory and north Western Australia, this effect is not evident. Figure 4.10 shows how claims frequency for strata products has changed across Australia.

Figure 4.10: Average claim frequency for strata products, 2007–08 to 2017–18



Source: ACCC analysis of data obtained from insurers.

4.4 Claims forecasting

Insurers were asked to provide their forecasts for net claims expense made each year going back to 2007–08. Not all insurers were able to provide their forecasts on a product by product basis and alternatively provided forecasts across their home, contents and strata portfolio instead. This section will consider data dating back to 2009–10 as that is as far back as we were able to obtain mostly complete data.

In real terms, across the industry, expected net claims expense (that is, net of recoveries from reinsurance) for all home, contents and strata products across Australia had been forecast to grow by an average of eight per cent each year since 2009–10. In 2017–18, the eight insurers have modelled total expected net claims expenses for all home and contents and strata insurance products to be around $3.6 billion, increasing to $3.9 billion in 2018–19. Figure 4.11 also shows that around 34 per cent of all of Australia net claims expense is attributed to natural catastrophes each year.

Figure 4.11: Expected net claims expense for all home, contents and strata insurance products across Australia, 2009–10 to 2017–18, real $2017–18

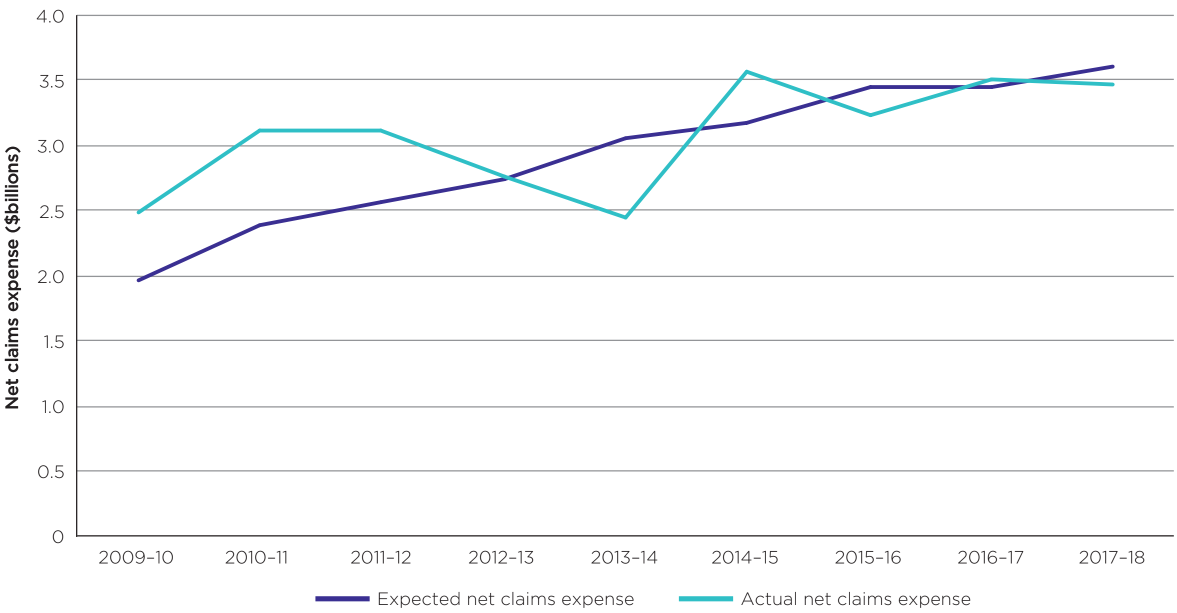
Source: ACCC analysis of data obtained from insurers.

Since 2009–10, the forecasts for non-catastrophe net claims expense have increased on average by seven per cent annually whereas forecast catastrophe net claims expenses have increased on average by around 10 per cent annually. This is expected to continue into 2018–19. Potential reasons for continued growth in expected net claims expenses include continued growth in the number of all home and contents and strata insurance products being supplied, and growth in housing stock.

Figure 4.12 below shows how the forecast net claims expenses compares to actual expense for home, contents and strata insurance across Australia.[46]

46 This figure does not include one insurer's in 2009–10, or another insurer's strata data after 2012–13.

Figure 4.12: Expected and actual net claims expense for home, contents and strata insurance products across Australia, 2009–10 to 2017–18, real $2017–18



Source: ACCC analysis of data obtained from insurers.

Figure 4.12 indicates that prior to 2012–13, insurers in aggregate underestimated their net claims expense by approximately $500 million each year. Only more recently have forecasts more closely aligned with the actual losses experienced. There was a wide range in the accuracy of forecasts amongst insurers for total net claims expense across all home, contents and strata insurance products. Three insurers accurately forecast their net claims expense most years. Two insurers consistently underestimated their net claims expenses, while one consistently overestimated. Two insurers had variable accuracy with their forecasts.

4.5 Reinsurance

Reinsurance is taken out by insurers, generally at a whole of portfolio level, typically in order to protect insurers from significant natural peril events impacting their portfolios. The reinsurance requirement differs greatly between the insurers who operate within northern Australia, and it is influenced by their level of exposure in northern Australia, the rest of Australia, and internationally.

There are various types of reinsurance available to general insurers, however two of the most common forms are proportional and non-proportional reinsurance.

Under proportional reinsurance arrangements, the reinsurer accepts a fixed percentage of both premiums and claims. Several insurers have purchased proportional reinsurance to reduce their total exposure and the amount of catastrophe reinsurance required.

Under non-proportional reinsurance, the insurer retains the cost of claims up to a certain threshold (the retention limit or excess) and the reinsurer pays the cost of claims above that point. Insurers usually purchase non-proportional 'excess of loss' catastrophe reinsurance policies to provide protection against large losses arising from catastrophic events such as cyclones or floods. They may also purchase aggregate reinsurance cover to provide protection against multiple catastrophic losses.

Non-proportional catastrophe reinsurance can provide protection against a concentration of insurance policies in a single location. APRA requires insurers to hold a certain amount of capital in order to protect against the risk of large losses, or multiple smaller catastrophe losses in a single year (insurance concentration risk). More generally, the amount of capital insurers are required to hold will be determined with reference to the overall risk of their portfolio.[47] Under the prudential standard model, an increase in concentration risk in a higher risk area can potentially increase the amount of capital insurers are required to hold and therefore may increase the amount of capital they choose to hold to maintain a buffer above the minimum required amount.

When an insurer purchases reinsurance, it will generally reduce the amount of capital it needs to hold.

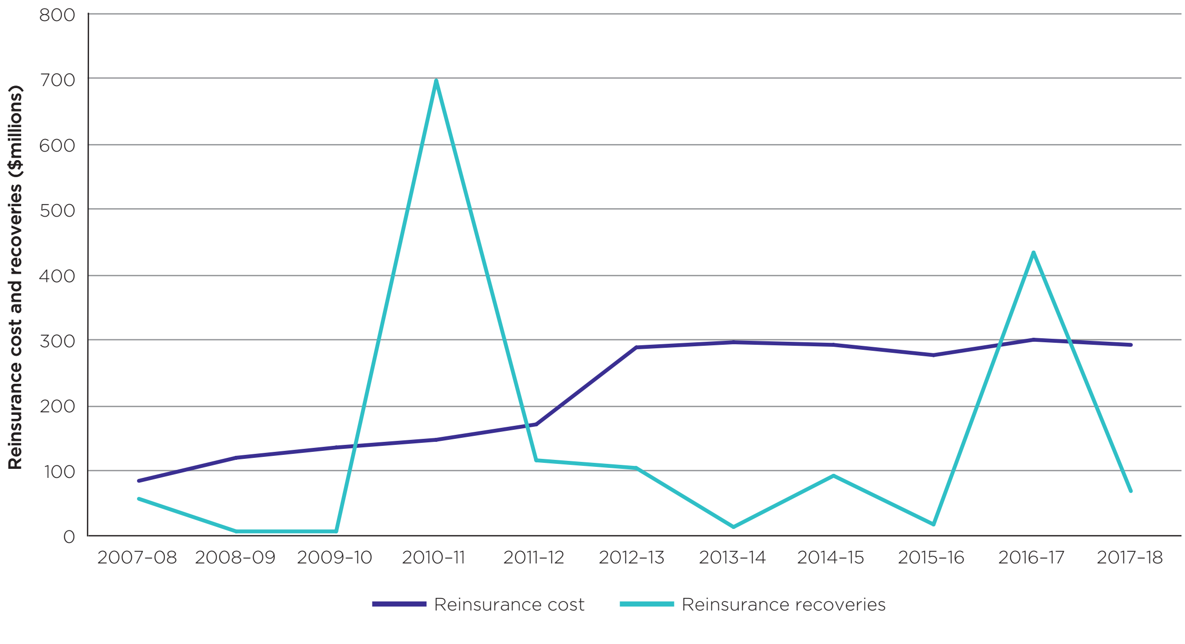
An insurer's concentration risk can affect premiums in northern Australia. For example, one insurer has noted that the cost of their reinsurance could be affected by an increase in their exposure in a high disaster risk area in northern Australia such as Port Hedland, Townsville or Mackay. Insurers seeking to limit their growth and concentration risk may have contributed to less price competition in certain areas. This is discussed further in chapter 7.

To reduce reinsurance costs, historically some insurers have engaged in joint venture reinsurance arrangements. In addition, some insurers used multi-year deals to lock in pricing.

In 2010–11, there was a large number of catastrophe events globally, which resulted in large claims for reinsurers and prompted an increase in reinsurance premiums. By 2013, the market had recovered leading to reduced pressure on reinsurance rates and by 2015 the market had softened to the point that insurers were budgeting a reduction in reinsurance costs. In addition, low interest rates globally encouraged the inflow of new capital into the reinsurance markets, further reducing upwards pressure on reinsurance rates. These trends in reinsurance premiums can be seen in the reinsurance expense line in figure 4.13 below. Figure 4.13 shows the total reinsurance expense and recoveries for insurers in northern Australia for all home, contents and strata products.

It should be noted that because reinsurance is purchased at an aggregate level, the data shown in figure 4.13 and figure 4.14 are estimates derived from allocations of reinsurance expenses and recoveries to historical periods using a current view of the catastrophe risk profile and not actual data.

Figure 4.13: Northern Australian reinsurance costs and recoveries, 2007–08 to 2017–18, real $2017–18



Source: ACCC analysis of data obtained from insurers.

The spikes in reinsurance recoveries in figure 4.13 are due to Cyclone Yasi and Cyclone Debbie, which both caused reinsurance recoveries to exceed reinsurance expenses in northern Australia.

The net cost of reinsurance is passed on to customers through premium loadings. There is no uniform way for an insurer to allocate its reinsurance costs to individual customers. Recently, the allocation of

47 An insurer may also decide to make adjustments to their premiums to reduce their concentration risk in a local area, or their overall level of risk; these are considered in detail in chapter 5.

catastrophe reinsurance cost to different products and areas appears to have changed. In particular, the improvements in catastrophe modelling have enabled the cost to be allocated more in line with the specific risk presented by each property. It is open to an insurer to maintain some element of pooling of reinsurance premiums across multiple properties, although it is not possible to measure the exact impact of this from the documents provided. Insurers pricing methods are discussed further in chapter 5.

The cost of reinsurance is of more significance to insurance products in northern Australia than in the rest of Australia. In northern Australia, from 2007–08 to 2017–18 insurers have collectively allocated between 41 and 59 per cent (52 per cent in 2017–18) of gross earned strata premium and 33 to 46 per cent (38 per cent in 2017–18) of all home and contents insurance earned premium to reinsurance premiums.

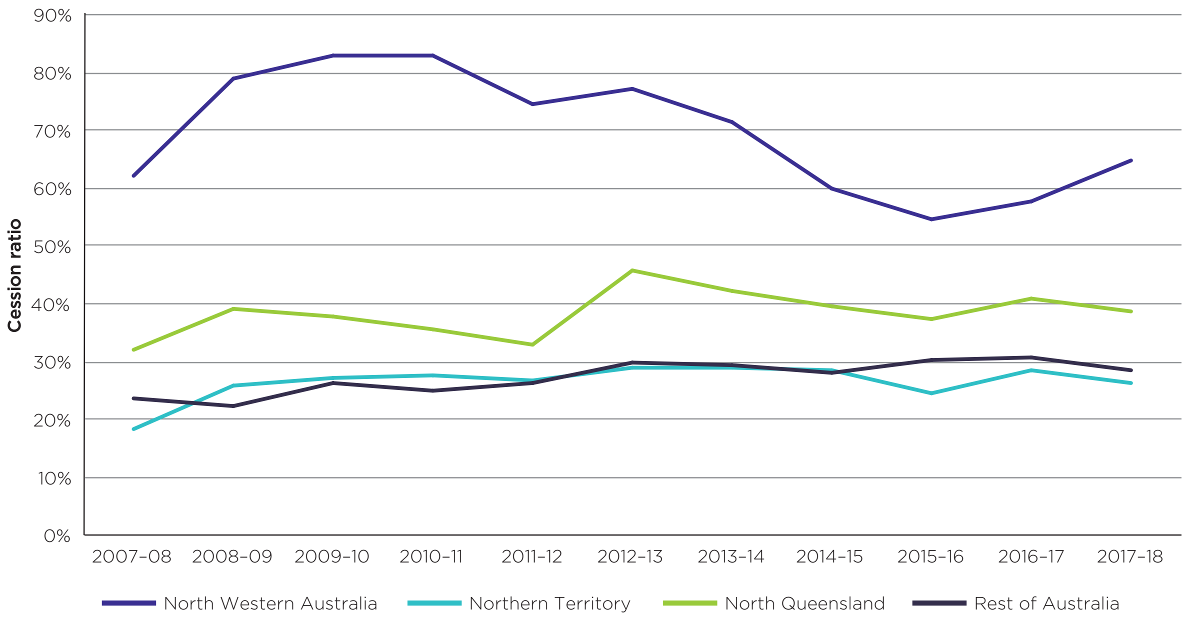
This is compared to between 11 and 32 per cent (26 per cent in 2017–18) of strata premiums and 24 to 33 per cent (30 per cent in 2017–18) of all home and contents premiums in the rest of Australia.

Overall, northern Australia makes up 12 per cent of national reinsurance expense, but represents 17 per cent of national reinsurance recoveries. This indicates that insurers are achieving better value from their northern Australian reinsurance than they are from the rest of Australia.

Cession ratio

The cession ratio is the reinsurance expense divided by gross earned premium. It shows the cost of reinsurance as a proportion of gross premium. Overall, the cession ratio is consistently higher in northern Australia than in the rest of Australia. This indicates that reinsurance prices are highly relevant to insurance premiums in the region. Figure 4.14 below shows the cession ratio across the industry for the different regions.

Figure 4.14: Industry wide cession ratio for home, contents and strata products, 2007–08 to 2017–18



Source: ACCC analysis of data obtained from insurers.

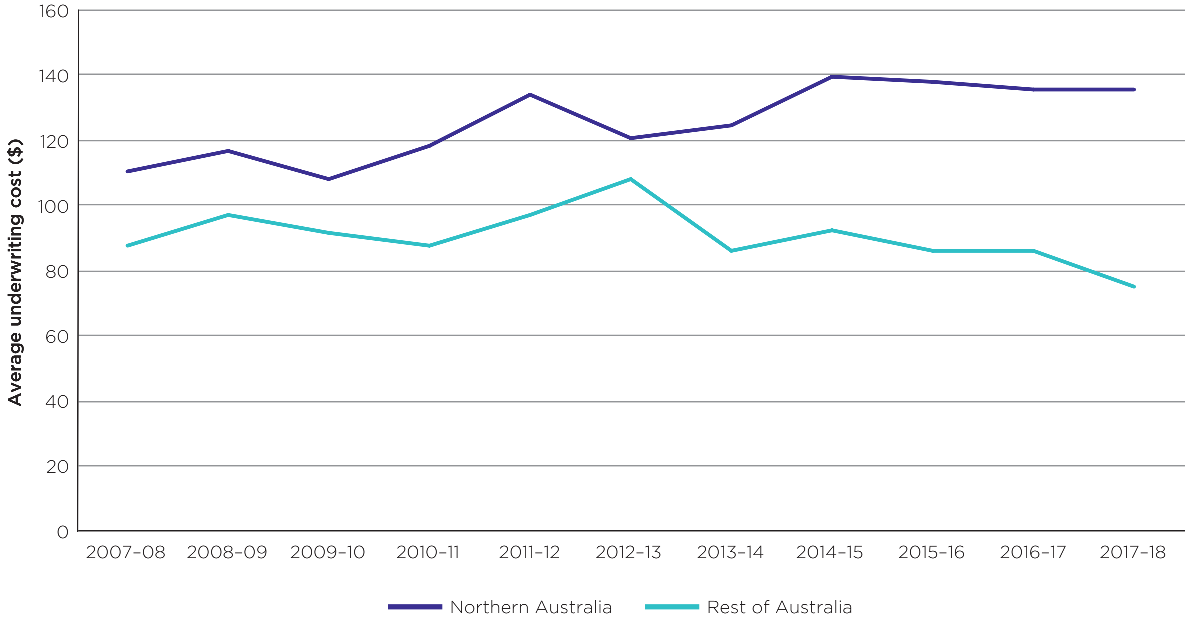
The increase in the cession ratio from 2011–12 to 2012–13 in Queensland likely due to the increase in reinsurance expenses following the large losses in Queensland in 2011–12. This is consistent with figure 4.14 above. The steady decline in the cession ratio for north Queensland and north Western Australia between 2012–13 and 2015–16 is also consistent with insurers' observations about the reinsurance market softening. North Western Australia has a very high and volatile cession ratio. It should be noted that this could be due to issues with the data, as north Western Australia has a low number of policies compared to the other regions and insurers do not usually disaggregate their figures to this level. The steady increase for the cession ratio in the rest of Australia is due to growth in reinsurance costs outpacing growth in gross written premium.

4.6 Underwriting costs

Underwriting costs are the costs to the insurer of obtaining and recording customers and their policies, excluding commission costs which are being considered separately.

Data shows that between 2007–08 and 2014–15 the underwriting cost per product for all home, contents or strata products was rising from $110 to $140 in northern Australia. Since 2014–15 the underwriting cost per product has slowly decreased to $135 in 2017–18. In the rest of Australia, underwriting cost per product peaked at $110 in 2012–13 and since then has been decreasing to a low of $75 in 2017–18. Figure 4.15 below shows the underwriting cost per product.

Figure 4.15: Average underwriting costs per home, content and strata product, 2007–08 to 2017–18, real $2017–18



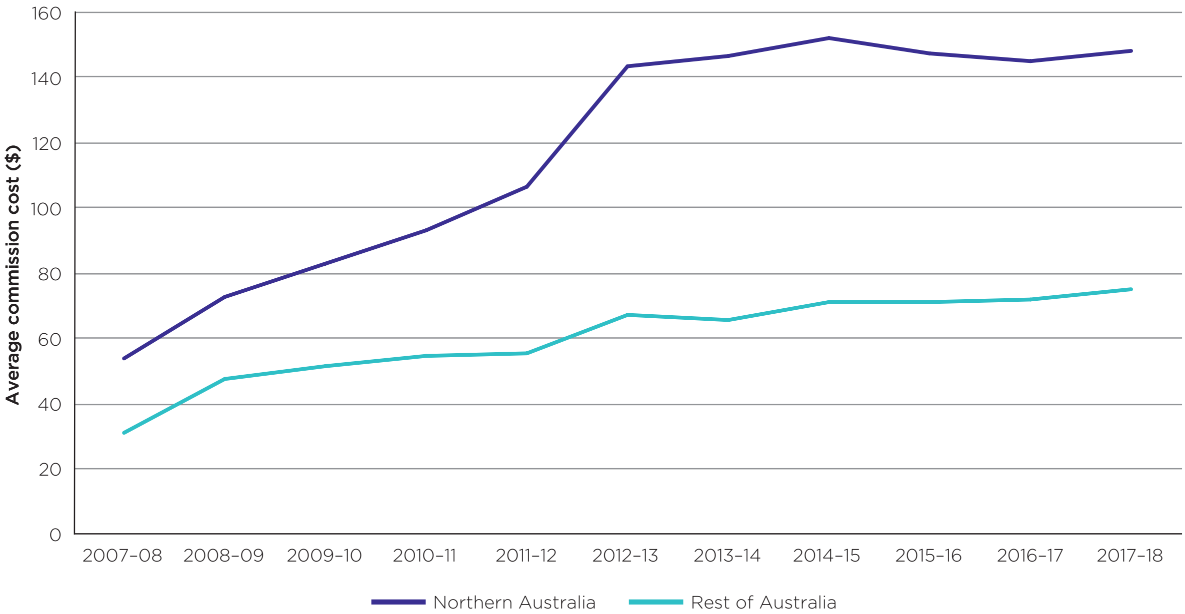
Source: ACCC analysis of data obtained from insurers.

4.7 Commission costs

Commission costs for all home, contents and strata products in northern Australia have quadrupled between 2007–08 and 2017–18, however growth has slowed since 2012–13. Commission costs are considered further in chapter 10.

Commission costs per home, contents or strata product are considerably higher in northern Australia than in the rest of Australia. This is shown in figure 4.16 below.

Figure 4.16: Average commission costs per home, contents or strata product, 2007–08 to 2017–18, real $2017–18



Source: ACCC analysis of data obtained from insurers.

The higher amount of commission cost per home, contents or strata product in northern Australia compared to the rest of Australia is likely due to commissions usually being calculated as a percentage of premiums, and premiums are higher in northern Australia. Additionally, the use of brokers is more common in northern Australia, as outlined in chapter 10.

5. How insurers set premiums

Key points

- Insurers generally set insurance premiums using a three staged approach. We observed that there are aspects of each stage of the process which are contributing to the high premiums observed in northern Australia.
- First, insurers set a technical premium which reflects their estimate of the cost of providing insurance with a profit margin added. High risk areas often have high technical premiums. The widespread cyclone risk, and to a lesser extent flood risk, in northern Australia has contributed to high technical premiums in the area.
- We have not seen evidence to suggest that insurers are taking an unreasonable approach to setting the technical premium in northern Australia, or that technical premiums for northern Australia are unjustifiably high. Instead, we have seen that insurers have invested significant resources in developing the models used to set technical premiums, and combined with better access to data, have allowed insurers to make more accurate assessment of risk.
- More granular pricing approaches, in particular address-based risk assessment, has been a key contributor to increased premiums for many consumers. As community rating and cross subsidisation across regions has been wound back, high risk consumers have experienced significant premium growth.
- We consider that measures, such as mitigation which help to reduce the risk or an area, or an individual property will help to reduce technical premiums to some extent.
- Secondly, insurers adjust their technical premium for a range of reasons such as managing their risk exposure and competitive or market positioning. Unlike the technical premium these adjustments are not directly related to the individual risk of the property. The use of these adjustments appears to be raising premiums for many consumers.
- Insurers use adjustments to the technical premium to alter their portfolio of insured properties, and in high risk areas to reduce their concentration risk or exposure. By increasing already high technical premiums, insurers can reduce the number of customers they have in a particular area or who they assess to be higher risk. This is leading to an unusual competitive dynamic where insurers are not using price to compete for market share in high risk areas.
- Discouraged by price increases, affected customers can be driven to other insurers, increasing the likelihood of those insurers making similar adjustments. These premium adjustments, and the underlying competitive dynamic, are adding to the affordability issues caused by the high risk of the area.
- Because these adjustments can increase retail premiums we consider there may be scope for premiums to fall. We are considering ways that these issues can be addressed, and will focus on this in the next stage of the inquiry.
- Thirdly, insurers apply discounts, surcharges, duties and taxes. Stamp duty is levied on insurance premiums as a percentage, so as premiums grow significantly, so too does the dollar value of stamp duty. The total tax (including GST and stamp duty) collected from home, contents and strata insurance in northern Australia has increased from $48 million in 2007–08 to $157 million per year in 2017–18
- We are proposing a number of measures that could be used to decrease the additional pressure that levying stamp duty places on consumers in northern Australia.

This chapter examines how insurers set insurance premiums. It provides an overview of pricing methodologies, before looking in detail at the different components of premiums and how the methodologies use by insurers have developed over the last decade. It considers the factors which are contributing to high premiums in northern Australia, and the reasons premiums have increased over the last decade.

5.1 Previous findings and stakeholder views

In 2014, the Australian Government Actuary (AGA) found that premiums for home and contents insurance in north Queensland had increased due to historic under-pricing of insurance, developments in catastrophe modelling, and increases in the costs of reinsurance.[48] In 2012 and 2014, AGA also found that premiums for strata insurance had increased for similar reasons, citing losses from natural disasters and higher cyclone risk in northern Queensland as contributing factors.[49] In 2015, the Northern Australia Insurance Premiums Taskforce found that following a number of cyclones in northern Australia, insurers reassessed their cyclone risk. This led to an increase in insurance premiums as insurers increasingly priced premiums to align more closely with the risk of damage, and did so at the individual property level.[50]

Industry submissions were generally consistent with these findings, with insurers and the ICA arguing that higher premiums in northern Australia are justified due to the high risk of the area.

The ICA submitted that the difference between premiums in northern Australia and the rest of Australia is 'reflective of the additional exposures'.[51] It suggests that part of the reason for higher premiums is that the northern Australian insurance market is small compared to the rest of Australia, but is disproportionately exposed to large and frequent natural disasters. In addition it submits that claims costs in the region can be higher due to a lack of infrastructure.[52]

Allianz also considers that the high prices of insurance in northern Australia reflect the risk associated with the extreme weather perils facing the area. It notes that northern Australia is vulnerable to cyclones, but also to flooding, and that both risks should be considered when looking at the affordability of insurance in the area.[53] Allianz submitted that one of the significant drivers of increases in insurance premiums was a large number of weather events starting with Cyclone Larry in 2006, and including Cyclone Yasi and Cyclone Marcia.[54] It considers that the impact of these events on claims costs, and catastrophe reinsurance quickly flowed through to higher premiums for all Australians, but that this was more pronounced for properties exposed to flood and cyclone risk.[55]

Suncorp submitted that natural hazard risk is the primary driver of insurance prices in northern Australia, and that cyclone is a significant reason for the difference in premiums in northern and southern Australia. In its submission Suncorp notes that there have been many natural disasters in northern Australia since 2006, and that insurers need to factor the risk of future catastrophes into their northern Australian premiums.[56] Suncorp considers that another reason for higher premiums in northern Australia is that there are many older homes which are more vulnerable to cyclone damage, and northern Australia is the most expensive part of Australia to build and repair homes.[57]

In its submission IAG highlighted the high cost of catastrophes in northern Australia, and research which found that many northern Australian regions face high to extreme cyclone risk, and many also faced high flood risk. IAG considers that a driver of price increases for insurance in northern Australia has been insurers more closely aligning their premiums with risk. It submits that premiums in northern Australia were previously subsidised by lower risk areas, the majority being located outside of northern Australia.[58] IAG notes that more generally, premiums have increased across northern Australia, and that a key driver of this was increases in building and repair costs, as well as insurers now covering more risks (such as flood).[59]

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48 Australian Government Actuary, *Report on home and contents insurance prices in north Queensland,* November 2014.

49 Australian Government Actuary, *Report on Investigation into strata title insurance price rises in north Queensland,* October 2012; and Australian Government Actuary, *Second Report on strata title insurance price rises in north Queensland,* May 2014.

50 Northern Australia Insurance Premiums Taskforce, *Final Report,* November 2015.

51 ICA submission, p. 4.

52 Ibid pp. 3–4.

53 Allianz submission, pp. 11–13.

54 Ibid, p. 13.

55 Ibid.

56 Suncorp submission, p. 3, p. 10.

57 Ibid, p. 19.

58 IAG submission, p. 16.

59 Ibid, p. 20.

The Institute of Actuaries of Australia submitted that while a range of factors lead to higher premiums in northern Australia, key contributors are the small size of the northern Australian market and the high exposure to natural perils. Other factors it considers have led to increasing premiums include the move to address based pricing of catastrophe risks, increasing repair costs, the introduction of flood cover, and decreased competition for customers in high risk areas.[60]

However, many consumers questioned the reasons behind increasing premiums. At our public forums in northern Australia, a number of participants who faced high premiums considered that they did not live in areas affected by cyclone or flooding, and that high premiums were not justified. Other participants were concerned that insurers didn't take the circumstances of their property into account, but set prices based on their postcode or region. Some were concerned that their premiums were being used to subsidise other parts of Australia. Submissions from consumers in northern Australia also indicated that the reasons behind the premium increases were not clearly explained, and consumers expressed doubts about the accuracy of risk data, particularly flood mapping, used by insurers.[61]

5.2 Overview of premium pricing

Insurers pricing methodologies are complex, and each insurer's exact approach differs. However, broadly the process for setting insurance premiums can be broken into three steps:

1. Determining the technical premium
2. Premium adjustments
3. Determining the retail premium.

The first step in setting insurance premiums is to determine the technical premium. The technical premium is the insurer's estimate of the cost to provide an insurance product with a profit margin added. Technical premiums differ across policies, as each policy will contribute to these overall costs to a different extent. For example, the technical premium for a high flood risk property will be greater than a low flood risk property (all else being equal) as the expected claims costs for the high flood risk property will be greater.

Once the technical premium is calculated, insurers often make 'premium adjustments'. The adjustments are typically made to increase premiums above the technical premium. These adjustments are changes that insurers make in response to other factors not specifically related to the property being insured. Adjustments can be made for a range of reasons such as competitive positioning, managing concentration risk, exposure and reinsurance costs, or customer retention.[62]

The final step is setting the retail premium, which involves applying any applicable discounts and loadings, taxes or duties to the adjusted technical premium. Discounts may be applied for things such as customer loyalty, online purchase and no claims bonuses. Loadings can be included for things such as monthly payment options. The insurer will then add any relevant levies, duties and taxes to give the final retail premium.

As discussed in detail below, there are a number of factors that impact the retail premium paid by a consumer. Some of these factors are under the control of the consumer, such as the exact sum insured, the selected excess level, and optional policy inclusions or exclusions. These are discussed below, but also dealt with in chapter 3 which considers how excess levels and sums inured affect premiums, and chapters 7 and 8 which consider inclusions and exclusions in more detail.

60 Institute of Actuaries of Australia submission.

61 For further information see, ACCC, *Northern Australia Insurance Inquiry: Public Forums*, www.accc.gov.au/focus-areas/inquiries/northern-australia-insurance-inquiry/public-forums.

62 An insurer's concentration risk can affect prudential capital requirements (considered in chapter 2). However this is assessed at the national level rather than more localised concentrations considered in this chapter.

5.3 Technical pricing

Generally, insurers consider the following cost components when determining a technical premium:

- expected claims costs
- reinsurance costs
- operating costs
- commission costs
- profit margin.

This section discusses how insurers estimate each of the cost components of providing the insurance products.

Approach to calculating expected claims costs

The following section provides an overview of insurers' approaches to estimating claims costs. As noted earlier in chapter 4, claims costs are the largest cost to insurers, and therefore they represent the largest part of the technical premium. Calculating the expected claims cost is one of the most complex parts of determining the technical premium, as these costs are uncertain and can be difficult to predict.

To calculate expected claims costs, insurers generally split claims costs into two categories:

- Working claims: these are claims that do not relate to natural perils or catastrophes, or other significant weather events. They include claims for things such as fire, theft, glass, and electrical or water damage (excluding from natural peril/catastrophe events).
- Natural peril or catastrophe claims: these are claims arising from natural perils, catastrophe events or other significant weather events. They include claims from flood, cyclone, bushfire, earthquake, hail, storm and storm surge. Insurers generally model expected claims for each type of peril separately.
- Insurers generally use separate models for the different claims types. While these models differ, they are usually 'frequency and severity' models. That is, the models will calculate the frequency (or the likelihood of the claim type occurring) and the severity (the likely cost of a claim when it occurs) of the claim type for a policy. The frequency and severity outputs are then used to calculate the per policy cost for the claim type, which depends on the characteristics of the particular property and its location. The output may also be adjusted (or depend on) other specific product features like the sum insured.[63]

Catastrophe or natural peril models

The models used by insurers to calculate natural peril or catastrophe claims are generally developed by industry specialists or reinsurers, such as Risk Management Solutions (RMS), Willis, and Finity Consulting, and are supplemented with insurers' own claims data. Part of the reason for this approach is the complexity of modelling catastrophes and the amount of data required. One insurer stated that it uses external models for catastrophic events, due to the scarcity of internal data for the pricing of severe weather events.

Insurers will also often use a combination of models, or make adjustments to the external models where they consider this is necessary. For example, one insurer adjusted the outputs of an external model used to estimate cyclone claims as a consequence of their testing of the model. The insurer considered that the model did not recognise the impact that the increased demand for building and repair work will have on the cost of services (demand surge), and that it did not fully recognise costs associated with the settlement of a claim (i.e. loss adjuster costs). At least two insurers have adjusted their flood models so that they better take building height, or number of stories into account.

63 We note that insurers generally use either a top down or bottom up approach to determine the claim cost per policy. The top down approach involves an insurer estimating the total average annual loss (AAL) for a particular type of claim, and then allocating the AAL to policies based on their relative risk. The bottom up approach involves calculating the expected claims cost for the policies in a portfolio, and using this to calculate the AAL, and the premium for the policy.

There is also a great deal of uncertainty in estimating expected catastrophe claims costs. A number of insurers commented on the uncertainty, with one insurer describing catastrophe (or natural peril) models as follows:

> 'Natural peril models are inherently uncertain. Mother nature is difficult to estimate—it is hard enough coming up with a two week weather forecast let along a long term cost of damaging weather...The range of possible values for natural peril models can be large. It is not uncommon to get ranges of estimates from...experts where the highest estimate is double the lowest estimate...this conveys the degree of uncertainty possible in these models.'

Rating factors

The models used to determine claims costs will take various characteristics of the property and policyholder into account. These characteristics or 'rating factors' are factors which have been shown to affect the likelihood of the policyholder making a claim, or the severity of a claim when it occurs.

Rating factors generally include characteristics of the property, the policyholder and the policy coverage. Table 5.1 provides examples of rating factors used by insurers to determine expected claims costs when setting the technical premium. Different factors will be relevant to different types of claims and will also impact model outputs to different extents. We understand though, that for most claims types, the location of the property and the sum insured have the greatest impact on the estimated claims cost.

Table 5.1: Example rating factors used in claims cost models

Property characteristics	Policyholder characteristics	Coverage characteristics
Sum insured	Age	Excess
Location	Retiree status	Accident damage
Building type	Claim History	Rent default
Wall and roof construction	Installments	Malicious damage
Number of stories	Tenure	Portable contents
Stilts	Other products	Special valuables
Pool		
Year of construction		
Occupancy		
Security		

The impact of higher building costs

As noted in chapter 4, and raised by some insurers in submissions, the cost of a claim in northern Australia can be higher than the cost of an otherwise identical claim in other parts of the country. This is due to differences in building (and repair) costs between regions. In more remote areas, and where building standards are higher, these cost differences can be significant. In the event of a major catastrophe, demand surge can further increase claims costs. Insurers factor these higher building costs into their models, and in calculators they provide consumers to estimate their sum insured.[64] Overall, this is one of a number of factors which are contributing to higher premiums in northern Australia.

Expected cyclone claims costs

Insurers model expected cyclone claims cost separately to other claims costs, to calculate the cyclone component of the technical premium for a policy (sometimes referred to as the 'cyclone premium'). As noted above, cyclone risk is often cited as a reason for higher premiums in northern Australia. As outlined below, our findings are consistent with this, and we have seen that the cyclone component

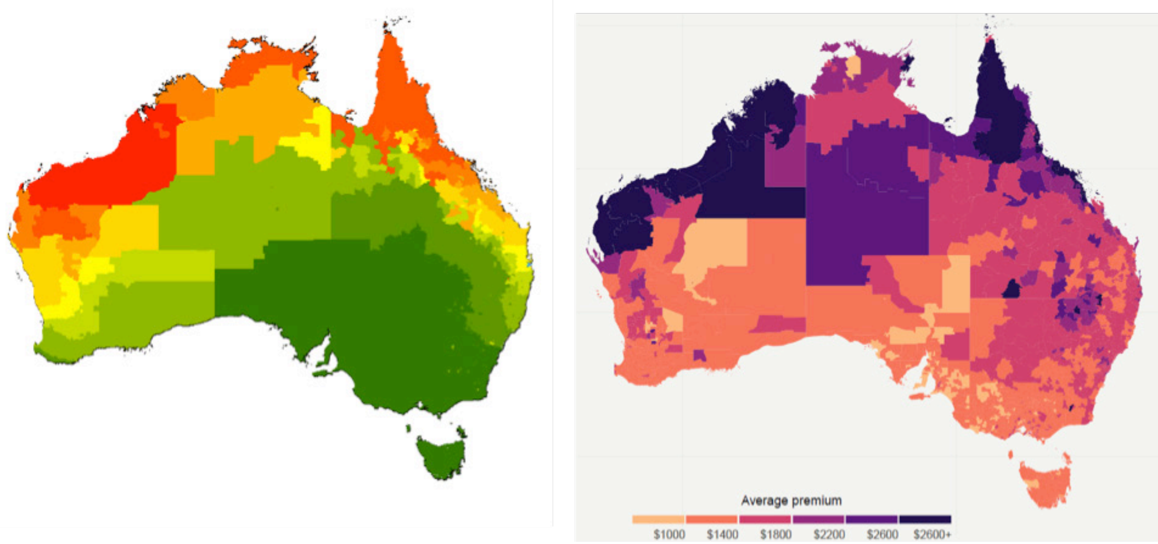
64 Decisions about sums insured and the use of calculators are discussed further in chapter 9.

of premiums can be high across a large part of northern Australia. This section looks at how insurers model cyclone components, and the scale of these in northern Australia.

Nature of cyclone risk

Insurers consider much of northern Australia is at high risk from cyclone. For example, one insurer has described cyclones as the greatest natural peril risk for Queensland, and classifies all of north Queensland within approximately 75 km of the coast as being a high cyclone risk area. Another insurer considers that of the 193 postcodes in northern Australia, only 27 were at no, or low, cyclone risk. Similarly, a map of cyclone zone relativities used by an insurer, at figure 5. 1 below, shows cyclone risk is high in many coastal areas in northern Australia. This is consistent with historic data weather records and significant claims costs from cyclone events in these areas (as discussed in chapter 4).[65] Figure 5.1 compares the distribution of cyclone risk, with average annual premiums in northern Australia, and shows that the highest premium areas correspond with the highest cyclone risk zones.

Figure 5.1: Cyclone risk compared to average premiums for home and contents insurance in 2017–18



Source: For the cyclone risk map at left, a document obtained from insurer. For the map showing average premiums at right, ACCC analysis of data obtained from insurers.

Note: In the cyclone risk map, red represents highest risk, and green lowest. The cyclone risk map was included in a document from 2014. Average premiums are for the 2017–18 financial year.

Information obtained from the insurers also suggest that the damage caused by cyclones can sometimes be less severe per property than for other events, such as flood or bushfire, but that it is often more widespread. For example, an internal report from one insurer on historic cyclone claims experience in northern Australia commented that cyclone losses are often characterised by many small claims, and that there can be substantial losses even at low wind speeds as a result.

Scale of cyclone components

The scale of the cyclone component of insurance premiums will differ significantly for different policies, and depends on a range of factors such as location and characteristics of the property. However, from documents obtained during the inquiry, we can make some observations about their scale in northern Australia and the rest of Australia, and how they compare to components for other perils.

For example, table 5.2, shows one insurer's average premiums for home building products in different cyclone risk areas in 2013–14. It shows that the cyclone component of premiums in high and very high risk cyclone zones (which are predominantly in northern Australia) can be very high, at between $480 and $1750 per year. This is much higher than the cyclone premiums faced in the southern parts of Australia where cyclone risk is likely to be low to nil.

65 See for example, Bureau of Meteorology, *Previous Tropical Cyclones*, at www.bom.gov.au/cyclone/history/index.shtml.

Table 5.2: Average cyclone component of annual premiums for home building insurance in different cyclone risk zones, 2014, $nominal

Cyclone risk level	Percentage of dwellings	Average premium ($)
Nil	52	0
Low	42	10 to 80
Medium	4	120 to 260
High	3	480
Very high	<1	1750

Source: Documents obtained from insurers.

Another insurer's internal documents show that for home building products the estimated average claims cost per policy for cyclone was approximately $850 for north Queensland, and $2500 for north Western Australia. In contrast, the estimated average claims cost per policy was $100 in Brisbane, $190 in the Gold Coast, and $87 in the rest of Western Australia. This suggests that cyclone risk is widespread in north Western Australia, and a contributor to that region having the highest premiums in northern Australia (as discussed in chapter 3).

We have also looked at quoted premiums by cyclone risk for properties in northern Australia to gain an understanding of how cyclone risk can affect premiums. Table 5.3 below illustrates that cyclone risk can make a significant difference to quoted premiums, with the average difference between lowest and highest cyclone risk properties being over $3000 per annum. We note that these are quoted premiums, and do not necessarily reflect what consumers in different cyclone risk areas are actually paying. We also note that some quoted data (for all cyclone risk level) may be for properties that are also in high flood risk areas.

Table 5.3: Quoted premiums for combined home and contents insurance for different cyclone risk properties, 2018

Cyclone risk	Average annual premium ($)
Low	1900
Medium	2600
High	3700
Very High	5000

Source: ACCC analysis of quote data provided by Finity Consulting.

Note: This data is based on a sample of quotes obtained from 16 insurers' websites. Cyclone risk levels are based on Finity Consulting's assessment of cyclone risk.

Cyclone component modelling

As for other perils, most insurers use models developed by external parties (or a combination of such models) supplemented with their own data to determine cyclone components. A key development over the past decade has been the increasing sophistication and granularity of cyclone models.

Currently, a number of the insurers assess cyclone premiums at an address level. That is, they assess each individual property's cyclone risk, rather than setting premiums for cyclone based on the average risk at a postcode or larger regional level. These insurers are able to make a more accurate assessment of the cyclone risk an individual property faces, because the characteristics of that property and its location are specifically considered. This is important because according to insurers, although cyclone risk is 'smooth in space' (i.e. the probability of a cyclone occurring is about the same for properties in the same region) the vulnerability of a property is more granular, and depends on local features. For example, the risk of damage from a cyclone is highly correlated with the slope, elevation and building characteristics of a property.

However, insurers have been slower to move to address level pricing for cyclone than for other risks, such as bushfire and flood. A number of insurers moved to address level pricing for cyclone risk between 2013 and 2017, while others have not done so to date. This may partly be due to limitations in modelling, but it also appears from insurers' documents that a contributing factor is that the probability of a cyclone occurring is not address specific to the same extent as bushfire and flood.

Insurers' rationale for the introduction of address level pricing is to more accurately set cyclone premiums. This is seen by the insurers as a way of sending the right price signals to consumers, and of more directly connecting the premium paid to the risk (and therefore to the cost) of providing the insurance. As noted in chapter 7, more accurate, granular pricing is also important to an insurer's ability to compete against other insurers, and prevent anti-selection. If an insurer is pricing policies at a less granular level, for example across a larger geographic area, it will likely overprice lower risk policies, and under price higher risk policies. This will result in a greater proportion of high risk customers for the same premium.

We have seen a number of comments from insurers about how more granular pricing can improve the risk profile of policies in their portfolios. For example, in 2016 one insurer said in an internal report, 'Following the [introduction of] enhanced cyclone pricing...the associated pricing strategy continues to reduce the acquisition of properties that are likely to be of sub-optimal construction'. Another insurer said that a move to more granular pricing of cyclone risk aimed to improve risk selection by better aligning pricing to risk. In relation to a pricing review that improved the sophistication of its storm and cyclone modelling another insurer considered that it would improve the mix of business in favour of lower risk customers, stating:

> 'It is likely that the premium changes will also result in [our] brands shedding a proportion of the high storm risks as well as new business risks written being skewed towards lower risks...This will come about by higher premiums being charged for higher risks, ...and is likely to have the largest impact in high cyclone prone areas.'

While address level pricing does allow insurers to more accurately assess risk, it has sometimes resulted in very large increases to premiums for some consumers, which is discussed in more detail below.

Rating factors

Documents obtained from insurers indicate that rating factors used by cyclone models often include the proximity of the property to the coast, the slope of the surrounding terrain, building construction factors (such as roof and wall material and the age of the building), and sometimes wind shielding due to surrounding buildings and vegetation.

Further, some insurers take mitigation works undertaken on a property into account when considering cyclone risk. Suncorp and RACQ, explicitly offer premium discounts to properties where activity has been undertaken to improve the property's cyclone resilience. Others consider that there is insufficient data to accurately account for consumers' mitigation activity.

The role of mitigation in lowering insurance premiums is discussed in more detail in chapter 12.

Cyclone pricing developments

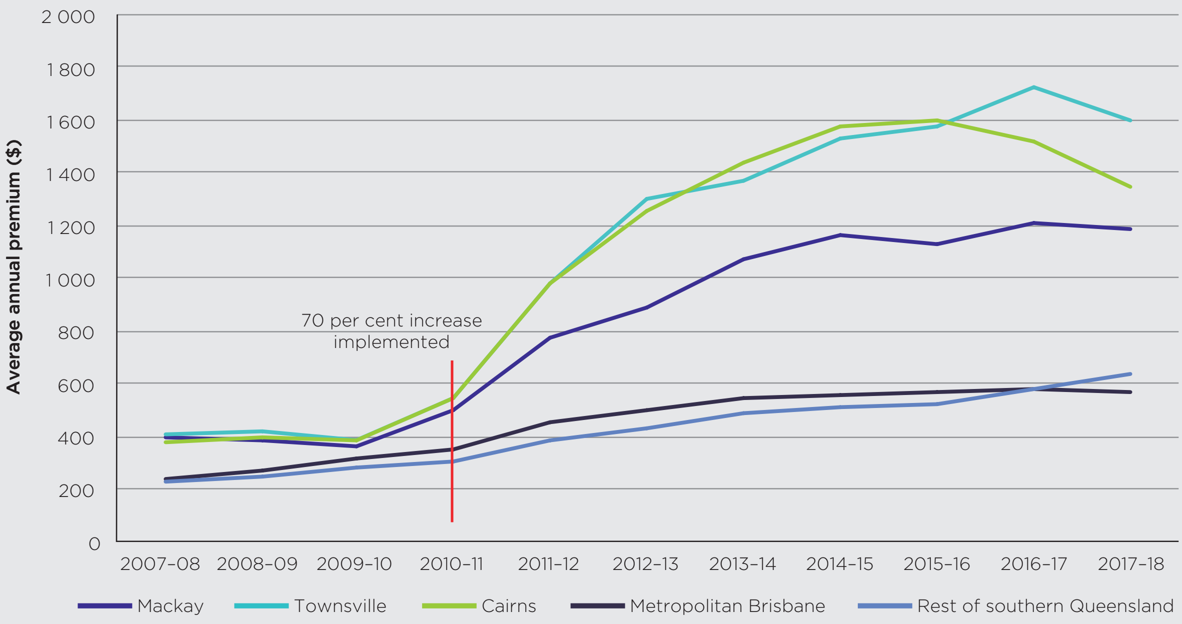
Documents obtained from insurers suggest that the increasing sophistication and granularity of insurers' cyclone pricing methodologies has led to higher premiums for many consumers in Australia. A number of case studies below illustrate this.

Case study 1: increases following catastrophes in 2010–11

In 2011, after the significant events in northern Australia, it appears that a number of insurers reassessed their pricing methodologies.

For example, one insurer asked an industry specialist to assess the technical premium required to cover cyclone costs in north Queensland. The specialist's model indicated that the insurer needed to increase premiums for building insurance by 70 per cent for policies north of Mackay, and the insurer implemented this change. Figure 5.2 shows how the increase in cyclone components impacted the insurer's premiums for home insurance in three of the largest cities in northern Australia following this change. It also shows that it is around this time that premiums for these areas began to significantly diverge from premiums in the rest of the state. We note though that the subsequent increases, and continuing divergence were likely a result of other pricing decisions.

Figure 5.2: Average annual premiums for home building insurance of one insurer in Queensland, 2007–08 to 2017–18, real $2017–18



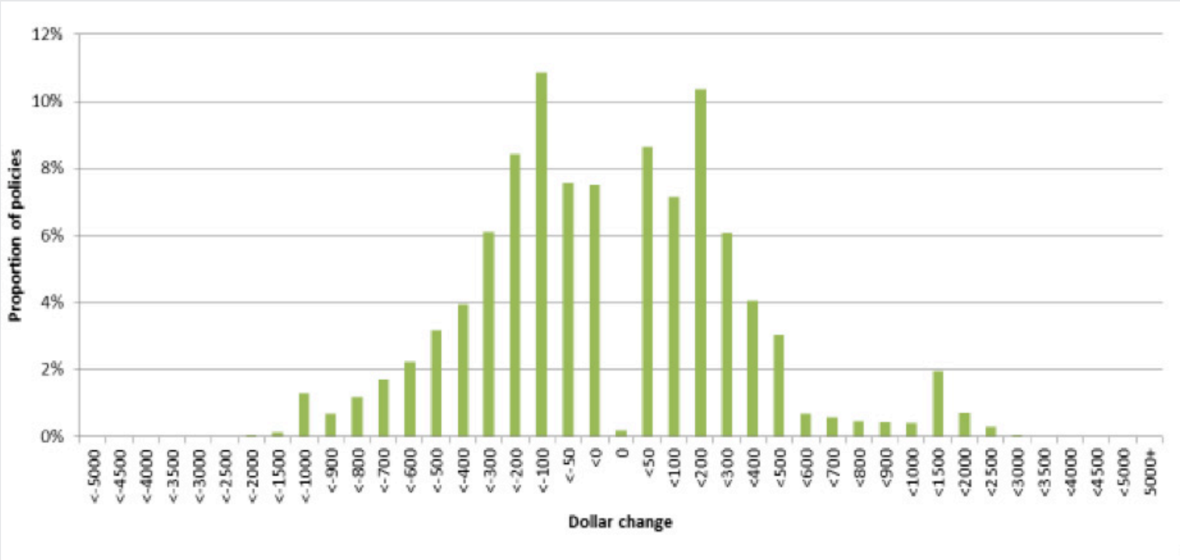
Source: ACCC analysis based on data obtained from insurers.

We also note that the insurer decreased contents insurance premiums by 10 per cent, to moderate the overall combined policy increase.

Case study 2: taking a more sophisticated approach

Another insurer introduced more sophisticated cyclone modelling, meaning that cyclone risk, and its effect on premium levels, was assessed on more detailed data, and new rating factors were introduced. This change was part of an overall change to the insurer's approach to storm cost modelling, which changed the way storm perils (including hail, storm surge and other storm) and earthquake perils were modelled. Overall these changes resulted in a premium decrease for about half of policies, and an increase for the other half of policies. This is shown in figure 5.3 below.

Figure 5.3: One year change in renewing premiums for home insurance in north Queensland following move to more sophisticated peril pricing, 2014, $nominal

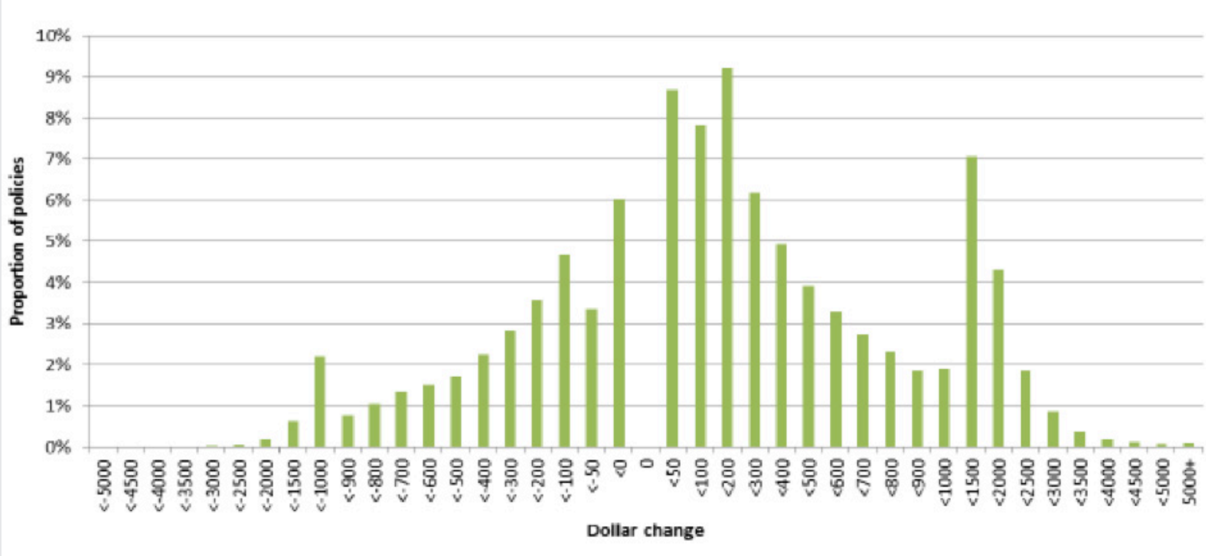


Source: Document obtained from insurer.

Note: The x-axis scale is not uniform.

The initial impact on renewing consumers was managed by 'capping' premium increases (a type of premium adjustment discussed in section 5.4) and the figure above does not capture any longer term effects on premiums of this move. Capping spreads the full premium increase over a number of years, and eventually renewing customers' premiums will reflect the new technical level. In contrast, premiums for new business in northern Queensland increased by about 20 per cent on average, or around $290, as a result of this change, as shown in figure 5.4 below.

Figure 5.4: Change in new business premiums for home building insurance in northern Australia following move to more sophisticated pricing approach, 2014, $nominal



Source: Document obtained from insurer.

Note: The x-axis scale is not uniform.

While on average the premium increases for renewals were small (at least initially), and for new business were 20 per cent, the above figures show that premiums for some consumers increased by a much greater degree. For example, for over 10 per cent of new business in Queensland, premiums for some areas grew over $1500.

We note that the above figures represent the change in premiums in northern Australia as a result of changing not only the way cyclone premiums were calculated, but also how other perils were calculated. However, it appears likely that much of the change in premiums in north Queensland, for this insurer, particularly where premiums have increased by more than $300 to $400, is a result of changes in cyclone pricing. This is firstly because cyclone appears to be the most widespread risk considered in northern Queensland, and because the cyclone component of premiums was generally the highest priced peril.

Case study 3: introducing address level pricing

One of the insurers adopted address level pricing for cyclone risks leading to both increases and decreases to cyclone components across their portfolio, which were often significant in size. For example, one consumer's target premium increased by 70 per cent, from around $3000 to $5000. For another consumer, where the cyclone risk level was assessed to be lower, the premium fell by 21 per cent from around $1900 to $1500.

Another insurer also recently introduced address level rating for a number of perils, including cyclone. They described the move as 'a rebalancing exercise where we charge more for high peril risks, at a location level, and less for low peril risks'. Overall, this change had the largest impact for policies in north Western Australia. The insurer noted that the areas near Broome and the Pilbara region, were not previously adequately priced. The rate change resulted in between around 8 to 10 per cent of new business premiums increasing by over 30 per cent, which the insurer said was in part due to cyclone risk in Broome and the Pilbara being under-priced. The insurer also noted that the introduction of address level pricing for cyclone was 'designed to positively influence [their policy] mix to reduce overall exposure'.

Following competitor monitoring in around 2015, another of the insurers, concluded that based on new pricing models for cyclone its competitors' prices were 'approaching technical levels', and they determined to implement address based cyclone pricing in Queensland and Western Australia in the following year. They had previously monitored competitors' prices to determine premiums, but noted that the shortcomings of this approach were that it did not differentiate on the basis of individual property characteristics or location.

Expected flood claims cost

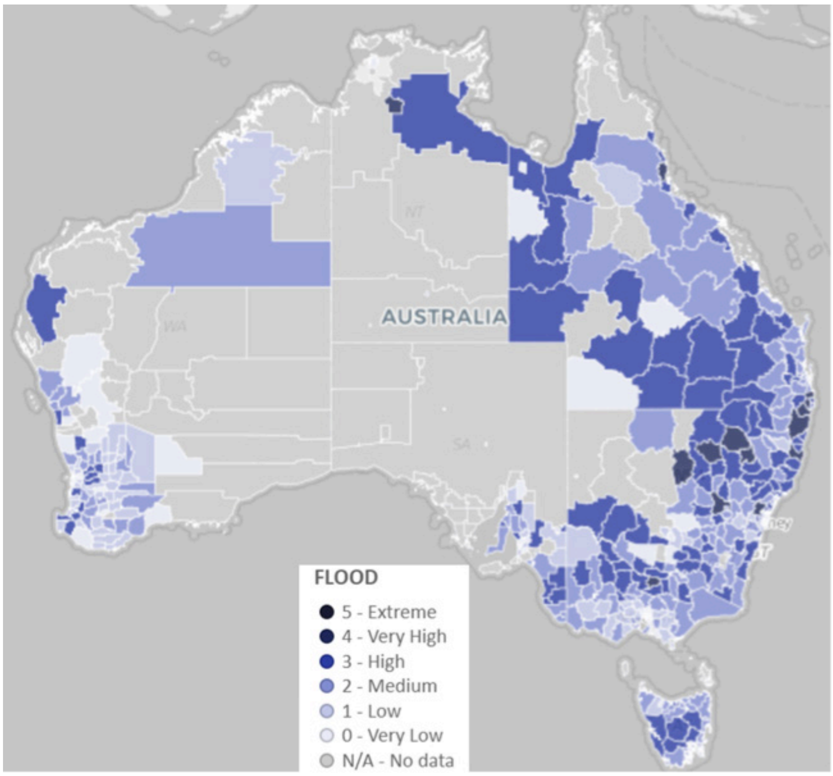
Insurers also separately model flood claims in calculating the technical premium. Flood risk is another factor which has been put forward by stakeholders as a contributor to high premiums in northern Australia.

The nature of flood risk and the scale of flood premiums

Flood risk is more limited than cyclone risk geographically, and while the occurrence and magnitude of floods are unpredictable, the areas which will suffer flood damage when a flood occurs are easier to model. Riverine flood risk depends on factors such as the distance of a property to a river channel, exposure of area upstream of the property to extended precipitation, the geology of the region, and any existing flood mitigation works that would reduce the risk of a property.

There are many parts of northern Australia which are prone to flooding, as illustrated in figure 5.5 below which was prepared by IAG (note there is data missing from a number of regions). However, unlike cyclone risk, flood risk is not limited to northern Australia, and there are higher risk areas across many parts of southern Australia as well.

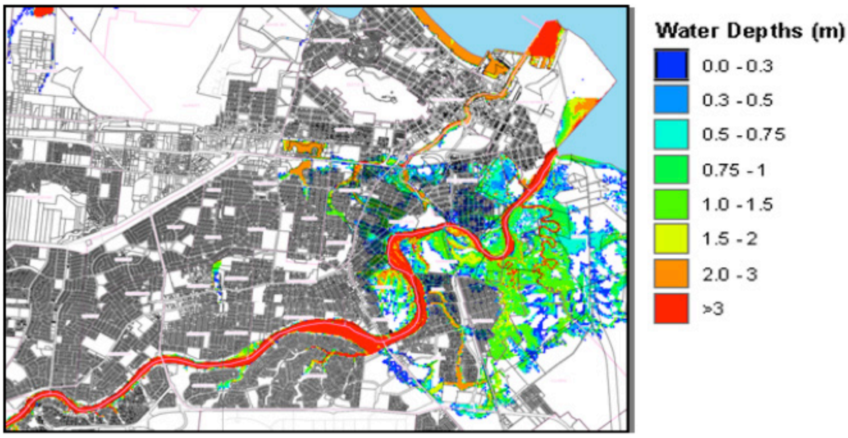
Figure 5.5: Flood risk map



Source: SGS (2016) based on IAG data (see www.sgsep.com.au/maps/2016/IAG/#).

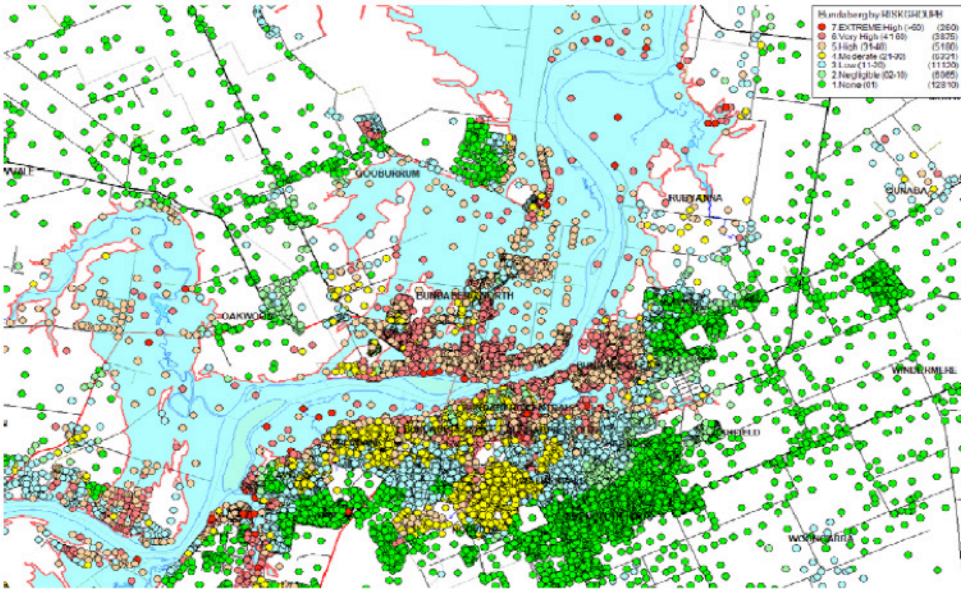
Flood risk is shown as uniform across regions in the above map, however, the risk of a flood is not uniform in all parts of a specific region, like it is for cyclones. The risk of flood typically varies markedly for properties within the same region, and sometimes even for adjacent properties. Therefore, flood risk generally needs to be considered at a more local level. One insurer's internal documents provided an example where the flood component of the technical premium within the same suburb could be between $90 and $8000. This is illustrated in the example flood maps shown in figure 5.6 and figure 5.7 below.

Figure 5.6: Example flood map for Townsville for 1 in 100 annual recurrence interval, 2013



Source: Document obtained from insurer.

Figure 5.7: Example flood map for Bundaberg



Source: Document obtained from insurer.

Note: Red and blue represents high flood risk while green is low risk.

Overall, these maps illustrate the more localised nature of flood risk when compared to cyclone risk, and this means that for many properties in northern Australia the flood component of premiums will be small.

However, there are still many properties in northern Australia that are impacted by flood, and many areas outside of northern Australia are also high flood risk. Looking at the distribution of flood risk across insurers gives an indication about the proportion of properties in Australia (and northern Australia) which are in high flood risk areas, but is also influenced by each insurer's pricing position and risk appetite (as discussed in more detail below).

One insurer estimated in 2011, that only two per cent of their policies had medium to high flood risk across the whole of Australia. However, as for cyclone, this small portion of policies accounts for the majority of the claims costs, and the insurer estimated that this accounted for 95 per cent of flood costs, which can be a substantial amount per claim (as discussed above).

Other insurers have estimated that a higher proportion of policies are at risk of flood. For example, one insurer estimated that in 2011 approximately 7.5 per cent of its policies in all of Queensland, were medium flood risk and above, but this included properties in south east Queensland, Brisbane and the Gold Coast. In around 2013, another insurer estimated a high flood risk in northern Australia. For example, in New South Wales it estimated 14 per cent of policies were in high to extreme flood risk area, but in contrast in the Northern Territory the figure was about 18 per cent, and 25 per cent in Queensland.

As for cyclone components, flood components of the technical premium can also be high. For example, one insurer calculated the average flood component for high risk properties as around $1300 per annum, and extreme flood risk at about $2200 per annum. Another insurer, estimated that flood risk could be over half of the total premium for a home building insurance product for a high flood risk policy. That is, it amounted to about $1500 of a $3200 premium.

Flood components, together with cyclone components appear substantially higher than other perils, which is discussed further below.

Quoted premiums for different flood risk properties in Australia also provides an indication of how flood risk can impact retail premiums. Table 5.4 below illustrates that flood risk does affect average premiums, but the impact is not as pronounced as it is for cyclone risk. On average the difference between the highest and lowest flood risk properties was nearly $1200 per annum. However, these figures are quoted premiums, and do not necessarily reflect what consumers in different cyclone risk areas are actually paying. We also note that some quoted data may be for properties that are also in high cyclone risk areas.

Table 5.4: Quoted premiums for different flood risk properties

Flood risk	Average Annual Premium ($)
Low	2200
Medium	2900
High	3000
Very High	3400

Source: Quote data provided by Finity Consulting.

Note: This data is based on a sample of quotes obtained from 16 insurers' websites. Flood risk levels are based on Finity Consulting's assessment of Flood risk.

Finally, we note that many of the high flood risk areas in northern Australia are also in cyclone prone areas. Overall, this means that flood prone properties in northern Australia can face both high flood and high cyclone components as part of their premiums.

Modelling expected flood claims costs

While the exact methodologies for calculating flood premium vary, most of the insurers model flood costs using the national flood information database (NFID). The NFID is an industry funded database which combines government flood mapping information into a single database which estimates the depth of flooding (at an address level) for 1 in 20, 1 in 50 and 1 in 100 year floods, as well as probable maximum flood (PMF) events. Most of the insurers supplement the NFID with models from reinsurers or industry specialists, as well as their own internal data. The coverage and accuracy of the NFID has improved since it was first released in 2009, and is periodically expanded. In 2013, the NFID supplied flood information for about 5.7 million properties, and insurers needed to supplement the data with industry models. As at 2016 the NFID contained flood risk information for 6 million addresses.

Today, most insurers model expected flood costs at an address level. As discussed in further detail below, this has happened progressively across the insurers over the last ten years. However, as there are still areas where address level flood data is not available, some insurers will still use suburb or regional ratings to set flood premiums for these areas.

Unlike cyclone risk, insurers do not seem to promote explicit discounts for flood mitigation works undertaken by individual consumers. However, insurers do take property characteristics that would reduce flood risk into account. One insurer considers that its model takes flood mitigation work into account, for example an expected decrease in claims for raising the floor of a property. Another insurer told us that flood mitigation works are considered on a case-by-case basis, and this is the only peril that this is done for. For this to occur though, the consumer must submit material to support an application for their flood risk to be reduced, which the insurer will assess.

Further, as discussed in more detail in chapter 11, insurers can also take into account community level flood mitigation works, such as levees, by updating the data underlying their flood models.

Flood pricing developments

Like cyclone component modelling, modelling the flood component of premiums has become more sophisticated and granular over time. It appears that for many insurers, a key factor in developing more sophisticated flood pricing were the legislative changes introduced by the Australian Government in 2012.

Flood cover was not widely offered by the insurers prior to the 2011. However, following widespread floods in 2010–11, the federal government introduced changes to the requirements around flood cover. In 2012, the *Insurance Contracts Act 1984* was amended to introduce a standard definition for flood, and to introduce a requirement that where an insurer wished to exclude flood cover from an insurance policy it must clearly advise a consumer that flood would not be included. Insurers had until 2014 to introduce these changes.

While it was possible for insurers not to cover flood in home and contents policies following the introduction of these regulations, most decided to include flood coverage as standard in contracts. Most also decided not to provide an option for consumers to opt out of flood cover. This is discussed in more detail in chapter 7.

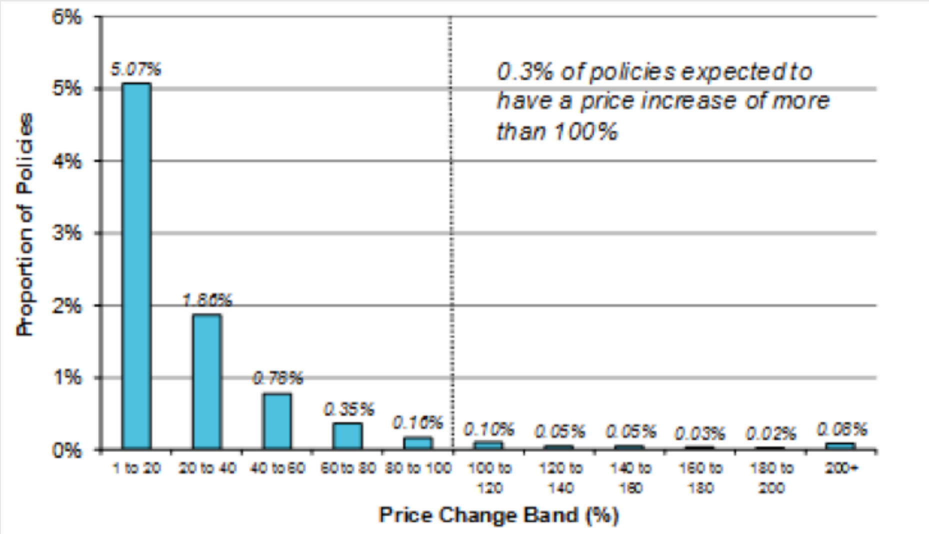
Following the introduction of default flood cover by many insurers, modelling of flood costs became more sophisticated and insurers have moved from rating flood risk at a regional or postcode level, to an address level. This has happened at different stages for different insurers and brands. As with cyclone risk, the impact of these changes varied between consumers.

The following case studies illustrate how insurers developed their flood models, and how this has impacted consumers in northern Australia.

Case study 4: introducing address based flood pricing

In 2013, one insurer introduced riverine flood cover as standard, with pricing based on risk at the address level. The change increased premiums for only 8.5 per cent of policies. Of these affected policies, the majority saw increases of less than 20 per cent. However for a small proportion of policies the premium increases were dramatic, with about 1.6 per cent of policies increasing in price by over 40 per cent and 0.3 per cent of policies increasing in price by over 100 per cent. The distribution of price increases is illustrated in figure 5.8.

Figure 5.8: Price increases following the introduction of address based flood pricing in 2013



Source: Document obtained from insurer.

Another insurer introduced new address based flood modelling in 2011–12. This change impacted only a small number of policies (three per cent across Australia) and 1800 customers across Queensland. However, the price increases for some consumers were substantial. As a result of the pricing change, the flood component of premiums increased at a national level by an average of $300 for medium flood risk, $1200 for high flood risk and $3200 for extreme flood risk.

Case study 5: pricing flood risk to deter anti-selection

As for cyclone, the accurate pricing of flood risk at an address level was seen by insurers as important to managing their risk exposure, or 'policy mix'.

For example, when one insurer introduced flood cover in 1999, it used 'broad geographic zones' to set flood premiums, and concluded that this meant 'low risk flood customers were subsidising high flood risk customers'. This also meant that the insurer had increased sales in high flood risk zones, and it determined that it needed to take action to avoid further adverse selection. This motivated the insurer to move to address level pricing for flood, introducing it in 2011–12.

Following this, the proportion of sales in high flood risk zones began to decline. The insurer commented 'that risk address flood pricing has been successful in reducing sales in Queensland'. They noted that the number of quotes taken up had decreased significantly in higher flood risk zones, and that sales in high and extreme flood risk areas dropped by 78 and 96 per cent compared to the previous year.

Similarly, in 2012, when another insurer introduced flood risk pricing at the individual property level, it noted that:

> *It will be an inevitable outcome that the technical price for properties with a high and extreme risk of flood will not be affordable for those policyholders. Similarly, [we] will aggressively defend [our] risk profile to ensure that it is not being selected against over time. Whilst challenging, these issues will be managed through discrete new business and renewal pricing strategies.*

Case study 6: TIO move from community rating

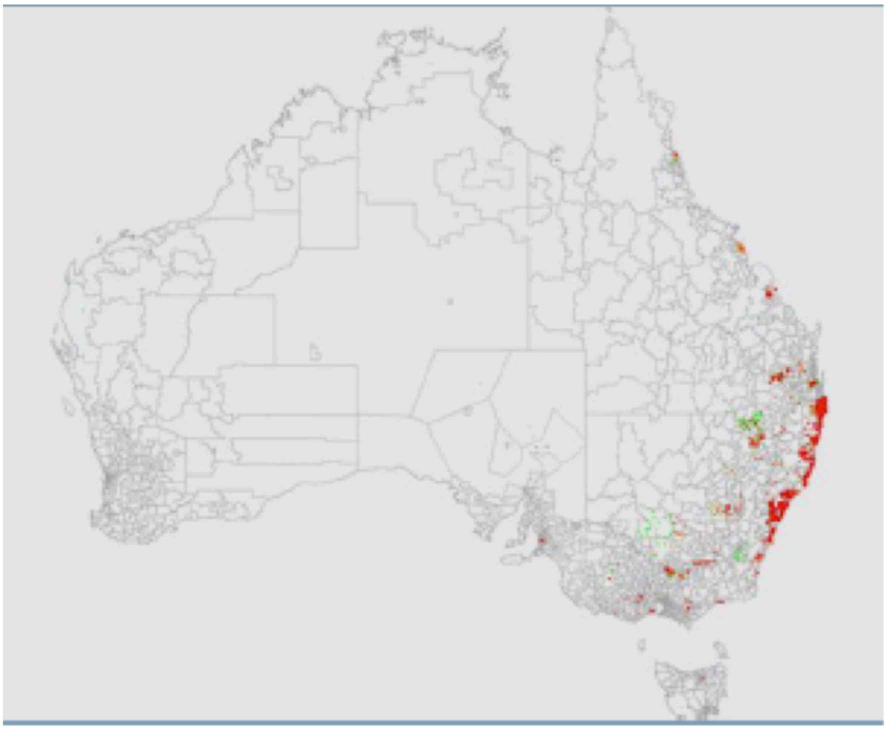
The TIO historically used community rating to price flood risk, but looked to move away from this to a technical premium in 2013 (prior to its acquisition by Allianz from the Northern Territory Government). In considering this, the TIO noted that unless it changed the way it rated flood risk it would likely adopt the majority share of the flood risks in Katherine, Alice Springs and the surrounding regions, as other insurers were introducing address based flood pricing at the time. Prior to 2013, the TIO used 5 flat flood rates, which were between around $20 and $130 depending on exposure. From 2014, the TIO moved to a more granular and technical method of rating flood risk (a full risk rated approach. They noted that this would lead to significant increases in premiums in flood zones in Katherine, Alice Spring, and Rapid Creek.

Flood premiums outside of northern Australia

Developments in flood modelling have not just impacted flood premium in northern Australia. For example, regions in northern New South Wales and parts of Victoria have also seen significant flood component increases as a result of the more granular assessment of flood risk.

For example, changes to flood pricing by one Insurer in 2012 had the greatest impact in New South Wales, and southern Queensland. This is shown in figure 5.9 below, where the red dots represent high flood risk policies which experienced the greatest premium increase.

Figure 5.9: Distribution of high flood risk policies following price change, 2011–12



Source: Document obtained from insurer.

Similarly when another insurer introduced address based flood pricing, 13 of the 20 suburbs which faced the greatest increases in flood pricing were located in New South Wales, two in southern Queensland and five in northern Queensland. Similarly, on introducing address based pricing for flood, it determined not to write business for certain high risk policies. The areas that were most impacted by this strategy, were mainly outside of northern Australia, with two thirds located in New South Wales.

Expected claims costs of other natural perils

There are a number of other natural perils which insurers separately model to determine the technical premium, such as bushfire, storm, earthquake and tsunami. While these risks will contribute to premiums in northern Australia, they will generally be smaller than flood and cyclone premium components.

Most insurers have developed their storm, hail and earthquake models over the period we have examined and some of them have recently moved to address level pricing for perils other than cyclone or flood. For example, from 2017 one insurer has rated storm at the address level, and considers factors such as location of the property, wind direction, shielding due to topography, vegetation, other houses, tree coverage and the property's elevation. Another insurer introduced address level pricing for a number of perils (cyclone, earthquake, hail and storm) in 2017.

Insurers have also improved their ability to assess bushfire risk, and many insurers have used address specific pricing from around 2010. Bushfires occur throughout Australia, but the impact that they have on claims costs varies across Australia. Bushfire risk is considered greatest in Victoria, and while parts of Northern Australia is may be to be quite susceptible to bushfires, it does not appear to greatly impact insurance premiums in the area as they generally do not occur in or close to residential areas. Historically, the worst bushfires (in terms of impact on populated areas) have occurred outside of Northern Australia (in Victoria, the ACT and NSW).

As noted above, earthquake, storm and bushfire premiums contribute less to northern Australian premiums than other risks. Further it appears that often, the contribution that these other perils make to the technical premium in high risk areas are generally lower than for flood or cyclone (which are discussed above). This is illustrated by table 5.5 below which is based on a sample of insurers' estimates of premiums for various perils (per policy) in 2013.

Table 5.5: Examples of estimated peril premiums, 2013

	Storm		Earthquake		Bushfire	
Risk zone	Percentage of dwellings	Average premium ($)	Percentage of dwellings	Average premium ($)	Percentage of dwellings	Average premium ($)
Nil	NA	NA	NA	NA	75	NA
Low	41	25 to 65	26	5 to 54	15	NA
Medium	32	70 to 90	50	67 to 210	7	100
High	26	110 to 170	0	202 to 300	2	200
Very high	NA	NA	NA	NA	1	700

Source: Documents obtained from insurers.

Note: Data in table obtained from more than one insurer. Note that percentage of dwellings may not add to 100 per cent

Overall, we consider that insurers are taking a consistent approach and not treating the calculation of the technical premium for flood and cyclone risk (which are a greater component of premiums in northern Australia) differently to the risks more common in the southern parts of the country.

Expected working claims costs

Working claims are essentially non-peril claims (or non-catastrophe claims), that arise regularly. For example they are claims for things such as fire, theft, water and/or electrical damage and glass cover. Insurers generally model working claims costs separately to catastrophe claims.

Overall, insurers' methodologies for determining working claims were broadly consistent. For most insurers working claims are determined by using internal claims data and experience, and external models are generally not used. The working claims models determine the frequency and severity for non-peril events taking a range of factors into account.

While the methodologies are broadly similar, the exact methodologies used by insurers to estimate working claims costs differ between insurers. Some will use different models to separately estimate large working claims over a threshold amount (such as $200 000 or $300 000) and small working claims. Each insurer also has different working claims categories that they model.

Generally, working claims are easier to model than peril claims as they are less volatile. However, modelling expected claims costs for these can still be complex. For example, many insurers use numerous models to predict the frequency and size of working claims.

From the information available, we have not seen evidence that suggests that working claims are a significant reason for price differences between northern Australia and the rest of Australia. Working claims will vary across the regions, for example, some regions may have greater risk of theft, and therefore have a greater working claims cost component to account for this risk. Higher building costs may also contribute to higher working claims component. However, generally working claims costs do not appear to vary across regions to the same extent as catastrophe costs, and it does not appear to be impacting the pricing of insurance in northern Australia to a much greater extent than in other parts of the country.

Pricing of the other cost components

As noted above, in addition to pricing for claims costs or risk, insurers also set the technical premium to take their other costs into account. Unlike claims costs, there is greater certainty about what the scale of these other costs will be in the coming year, and the main issue for setting premiums to recover these costs is determining how they should be allocated at a policy level.

Reinsurance costs

As noted in chapter 4, reinsurance costs are the largest component of premiums after claims costs, and the information obtained during the inquiry suggests that it is a significant factor contributing to higher premiums in northern Australia. For home and contents, and strata insurance, insurers will generally purchase 'excess of loss' reinsurance to protect against large and unpredictable catastrophe events.

In calculating the technical premium, insurers take into account the net costs of reinsurance; that is the reinsurance premium less expected reinsurance recoveries (or payments from the reinsurer). The key issue for determining the reinsurance component of a technical premium for a policy is how the net reinsurance costs should be allocated to a policy level.

The way insurers have allocated reinsurance costs to policies differs and has changed over time. Many insurers allocate reinsurance costs to policies based on the amount that the risks covered by those policies will contribute to reinsurance costs. One insurer bases its allocation of reinsurance costs on premiums, risk counts, sum insured and historic losses. A number of other insurers take more detailed approaches, developing models to allocate the cost of reinsurance based on how policies contribute to the reinsurance cost, or allocating based on a range of factors such as business line, location, and even property characteristics. However, it does not appear that all insurers are taking such an approach, and that some have spread reinsurance costs more evenly across policies.

Therefore, it appears that generally reinsurance costs will be allocated at a relatively higher rate to consumers in northern Australia than for the rest of Australia, as they are seen as being at a higher risk.

Operating costs

Operating costs include things such as administrative expenses, marketing and claims handling costs. Again, these costs are relatively straightforward to predict for an insurer and the key issue is how insurers allocate these costs across policies.

Some insurers allocate most operating costs uniformly across Australia, but other insurers take the characteristics of the policy into account when allocating some types of operating costs. For example, one insurer allocates a larger portion of administrative expenses to new business than to renewals. Claims handling expenses can be allocated based on the probability that a claim will be made under a policy, or the likely complexity and type of claim. Another insurer explained that it allocated claims handling costs based on product, sales channel and percentage of gross written premium.

To the extent that general overhead costs are apportioned by the share of gross written premium and expected claims frequency, consumers in northern Australia can incur a higher share than consumers in the rest of the country. This is likely contributing to higher premiums in northern Australia, but to a smaller degree than other factors. As discussed in chapter 4, operating costs (or underwriting expenses), do appear to be higher in northern Australia than the rest of Australia (as discussed in chapter 4) by around $150 per policy.

Commission costs

Commission costs for an insurance policy will depend on the way the policy was purchased. Where a policy is purchased directly from an insurer, there will be no commission costs (although the operating costs component may be higher as the insurer will spend more things such as marketing and sales when selling directly). However, where the insurance is purchased through an insurer intermediary, such as a distributor, authorised representative, a broker or another intermediary who sells insurance on behalf of an insurer, there will usually be some commission included in the premium paid.

Commission costs are discussed in more detail in chapter 10, but it is worth noting here that the commissions rates charged do not appear to vary greatly between northern Australia and the rest of Australia. While commission costs may represent a similar proportion of the overall premium for a product in northern Australia, they will be higher in dollar terms due to higher levels for other cost components.

Profit margins

Once an insurer has determined the scale of the technical premium based on the costs of supplying the product, they will add a profit margin to the amount. In the information provided by insurers they generally express the profit margins as a target return on equity across the whole of an insurance portfolio. For home portfolios we have generally found that the target return on equity is between around 10 and 25 per cent, and have generally remained unchanged or have decreased between 2008 and 2017.

A number of insurers have applied the target return on equity uniformly across Australia. While this is applied uniformly to policies, as it is a percentage of premium, policies with a higher premium will make a greater dollar contribution to profit than policies with a lower premium. However, these policies will also require higher levels of capital reserves, given they are higher risk.

However, we note here, the information obtained from insurers does not appear to suggest that they are adding a greater profit margin to the technical premium for northern Australia than they are for the rest of the country.

The profit margin for pricing purposes is set using a target return on equity. Actual profitability is discussed in detail in chapter 6.

Insurers' approach to setting the technical price

Overall, we consider that insurers' approaches to setting technical prices do not appear to be unreasonable, and that over the period insurers have adjusted their approach to setting the technical price to make more accurate estimates of the cost of providing the policy.

While technical prices for home, contents and strata insurance are higher in northern Australia, this appears to be driven by the cyclone and flood peril components of the premium, and to a lesser extent by the reinsurance component.

5.4 Premium adjustments

As noted above, once insurers determine the technical price they will often make further 'premium adjustments' to this, but these adjustments are not directly related to the individual risk of the property. Premium adjustments are made in response to factors such as the insurer's aggregate concentration of risks and market position. These adjustments are also distinct from any explicit discounts or surcharges which may be applied to a premium (these are considered at section 5.5) because they are not transparent to consumers.

These adjustments are common across the insurers and it appears that such adjustments are made to many policies. One insurer told us that these types of variations were made for around 80 per cent of policies, and on average these adjustments led to a 20 per cent difference between the technical premium and the premium paid by consumers.

While these adjustments are often reasonable commercial decisions, they can lead to issues for some groups of consumers. The reasons for, and the effect of, various categories of premium adjustment are discussed below.

Concentration risk, exposure and reinsurance costs

We have found a key reason for insurers making premium adjustments is to alter the stock of properties they insure in order to reduce their concentration risk, reduce their exposure in an area, or to lower reinsurance costs. These factors are often related, and an insurer may make an adjustment to its premiums for a combination of these reasons. Briefly, each type of adjustment can be described as follows:

- **Concentration risk:** Concentration risk occurs when an insurer considers it has too many risks in an area, such that if there was a catastrophic event, the loss to the insurer would be unacceptable. Insurers will often increase premiums to reduce their concentration risk in an area that they consider to be high risk.[66]
- **Exposure:** In areas where an insurer may not have a high number of policies, it may still wish to reduce its exposure in the area if it is outside of its 'risk appetite'. Again, insurers will often increase premiums to reduce exposure in particular areas.

66 APRA's Prudential Standard GPS 116 also requires that insurers maintain adequate capital against the risk associated with insurance concentration. Prudential capital requirements are considered further in chapter 7.

- **Reinsurance costs:** Insurers may make adjustments to premiums to reduce their reinsurance costs, by reducing their exposure in high risk areas.

We have seen many examples of insurers making these types of adjustments over the last ten years.

We have seen a number of insurers make adjustments to their premiums to lower their flood and cyclone concentration risk in particular areas. For example, in around 2012, one insurer introduced a new rating factor specifically for concentration risk. This was used to adjust premiums at a postcode level. The aim of introducing this factor was to avoid clusters of high market share in areas exposed to natural peril risks. It also followed a commitment made to reinsurers to manage concentration risk more actively through more targeted risk selection.

The concentration risk was calculated at a postcode level and was based on the market share, natural peril risk, total sum insured and the marginal cost of reinsurance of the postcode. The introduction of this rating factor generally resulted in all states, except for Queensland, seeing a reduction in premiums on average. On average for home insurance in Queensland, premiums for new business rose by nine per cent, and premiums for renewals rose by 1.8 per cent (due to 'capping' the amount that renewal premiums could increase in a single year was limited; this concept is discussed further below).

However, around 33 postcodes across Australia saw premium increases of between 15 and 20 per cent, with 17 of these in north Queensland. Areas around Brisbane and some Victorian postcodes were also impacted significantly.

Another insurer, made premium adjustments for concentration risk following the introduction of flood cover and a more granular approach to flood pricing. The insurer increased the flood component of premiums for a number of suburbs it identified as having a large growth of high flood risk properties and a high concentration of flood risk, up to a maximum of $1500 per $100 000 insured. Areas with the highest growth and number of high risk policies received the greatest increases in premiums. This change led to significant increases in a number of regions. In some regions the flood component (or flood loading) of premiums increased by over 400 per cent, and in one region by 700 per cent. Many suburbs in northern Australia saw significant premium increases of up to 360 per cent.

In 2011, one insurer decided to use premium adjustments to reduce its exposure to cyclone risk in general. It therefore determined to price its policies in northern Australia by between 20 to 40 per cent higher than one of its competitors depending on the distribution channel, and to stop writing new business through some of its distribution channels. Over a three year period this saw premiums increase by 100 per cent in northern Australia. We note that it subsequently changed its strategy and now uses a more granular technical price for northern Australia.

As noted above, exposure to high catastrophe risk areas can increase reinsurance costs, although it is only one of many factors which will determine reinsurance premiums.

We have seen many examples of insurers increasing premiums in an attempt to decrease reinsurance costs. For example:

- In around 2011, one insurer made adjustments to its premiums in northern Australia in order to reduce reinsurance costs. In relation to increasing premiums, a senior manager said in an internal email, 'I would really like us to go as hard as we can in FNQ (or even Queensland overall). I think we need to show the reinsurers some action.' Later in the consideration of premiums for north Queensland they commented, 'I would like us to do something more in FNQ [far north Queensland] above and beyond what we're doing for QLD generally...I think we need to go to the reinsurer... with more evidence that we are trying to slow growth in FNQ'. The recommended increase for home insurance in Far North Queensland was 40 per cent, compared to 18 per cent for the rest of the state. Further, the insurer commented later in the year that it needed increased premiums in northern Australia to moderate its exposure in the region, as it had driven 'a material proportion of [its] increased reinsurance costs in future periods'.
- Also in 2011, another insurer noted that pricing at the upper end of the market, and avoiding marketing which may attract high risk customers, was seen as a way of gaining a more attractive program from reinsurers. At the time it stated that cyclone risk accounted for about 70 per cent of their catastrophe reinsurance program.

- In 2011, another insurer noted that events of that last year (i.e natural catastrophes in Australia) 'coincided with significant losses across other regions of the world had been having a significant impact on reinsurance capacity and premium rates'. They then noted that this had impacted their own reinsurance program. As a result, the insurer increased premiums with an increased focus on high cyclone and flood risks, ceased writing new business in areas where other insurers were not providing insurance or were higher risk areas.
- In 2013, another insurer identified that portfolio growth in northern Australia was increasing their reinsurance premiums, and that without further action this would continue. As a result they decided to 'use pricing as a lever to arrest growth' in two high hazard areas in northern Queensland, (Townsville and Mackay). In total, the insurer increased premiums for new business by between 10 and 20 per cent for home insurance, and five per cent for contents insurance.
- In around 2013, another of the insurers implemented a 100 per cent increase in premiums in the Pilbara for a number of its distribution channels. The change was made as the insurer considered it was under-priced, and had high conversion rates. The increase was also made to reduce exposure in the area, as it had a direct impact on their catastrophe reinsurance program due to the high cyclone risk of the area.
- More recently, another insurer appears to have increased premiums by 10 per cent in coastal towns in north Queensland (Mackay and Townsville), to reduce exposure and new business sales and thereby reduce reinsurance costs.
- One insurer noted in a number of its reports to reinsurers, that it had taken a range of measures to control its exposure in cyclone zones. For example, it noted that it had 'tightened risk acceptance criteria and [used] deliberate price changes'.

The examples set out above all represent decisions by insurers to actively price themselves out of the market for a segment of the market. Premiums were increased to either slow or stop new business, or to discourage existing customers from maintaining their coverage. This is an unusual market dynamic.

Responding to competitors' pricing

From the documents obtained during the inquiry, we have observed that insurers closely monitor competitor pricing and adjust their own prices in order to achieve or maintain their desired market position. One insurer described their process of making these types of adjustments as being aimed at realigning competitiveness in response to changes in competitive position and recent sales and retention experience.

Similar to the premium adjustments described above for risk concentration and exposure, competitor adjustments are also often made to avoid being priced below competitors in high risk areas and avoid anti-selection.

These adjustments are discussed in detail in chapter 7. However, it is worth noting here that as for the above adjustments, many of the adjustments made in response to competitor pricing have led to premium increases for consumers in higher risk areas.

Capping and cupping

Capping is where insurers set a maximum amount that premiums may increase at renewal. For example, an insurer may set a cap of 20 per cent for home and contents product premium increases, even if a change in the technical premium, or a premium adjustment would otherwise lead to a greater increase. Capping is often used as a way of minimising price shock to customers and smoothing premium increases across many years.

We have seen many examples in the information obtained from insurers of the use of capping, particularly following the introduction of flood cover or where address level pricing of a risk has been adopted. For example, on the introduction of address level flood pricing, one insurer capped premium increases for existing business at 30 per cent in a single year. Using this capping meant that premiums for existing customers would not reach the technical rates until the fourth year after the price change was introduced. Another insurer used a 25 per cent cap following a flood price review, in order to 'mitigate large premium increase for customers within high flood areas in North Queensland.'

Cupping (also referred to as collaring) on the other hand is a limit on the amount of premium reduction. Cupping rates are also often used following a change in the technical premium. We have seen fewer examples which discuss insurers' use of cupping, particularly in northern Australia. However, we have seen some explanation behind the use of cupping.

Box 5.1 Rationale for the use of cupping

In arguing for cups limiting premium decreases to around 3 to 10 per cent, instead of 20 to 25 per cent, a senior manager at one insurer said in an internal communication:

'Having large premium decreases on renewals reduces our credibility. This is worse in the intermediary market where the intermediary sees this multiple times in contrast to direct customers who only see their own individual policies. Intermediaries want to see their commission income at least maintained, not reduced. This is a problem for them that has been raised in the past quite vehemently... Regions indicated that if the negative collars are excessive, intermediaries will demand that they individually reduce the collars to zero for their account no. or ask for commission rate increases. The regions said that they want to avoid both of these scenarios.

Premium stability is highly important because the broker can move the entire portfolio if rates change too fast too quickly. And where rates are not generally required to increase by large amounts, it affords us the opportunity to move to technical rates more gradually, particularly if retention is moving towards its maximum levels. Balancing this, we need to get both our new business and renewal books as close to correct technical rates as quickly as possible to ensure that we get the right selection of risks and maintain profitability'.

Therefore it appears that in at least some cases, the full benefits of decreases in technical premiums may not be passed onto consumers for some time.

New business versus renewals

Most insurers provide explicit discounts for new customers and/or longer-term customers as set out in section 5.5 below. However, some insurers appear to also make premium adjustments (which are not visible to consumers) raising prices for renewing customers to offset new customer discounts, or depending on a customers expected likelihood of renewing.

One insurer noted the rationale behind the practice was to 'enhance profitability by leveraging customer loyalty' but also that 'with increasing consumer awareness and competition, the success of this strategy has been challenged'.

Another insurer has stated there is a cross subsidy from renewing business to new business, as new business has higher claims costs. However, it states that if higher premiums were offered to new customers it would impede sales and portfolio growth.

The difference between new business premiums and renewing premiums varies between insurers. For example, one insurer charged renewing customers on average between 15 and 20 per cent more than new customers. We note that this difference between premiums for new and renewing customers for this insurer may have been influenced by a number of factors, such as differences in excess levels, the changing nature of the portfolio, and discounts for new policies.

Adjustments in response to high claim years

A final category of adjustments we observed was an increase in premiums for some policies following high claims years. The documents obtained during the inquiry show a number of insurers increasing premiums in response to the natural catastrophe events in 2010–11. Some changes made in response to the events were to adjust the methodology used to calculate the technical premium. However, a number of these adjustments were in reaction to the impact that these events had on insurers expected performance targets for their home portfolios.

For example, one insurer decided that following the events in 2010–11 it needed to enhance its technical pricing capability, but that in the interim period:

> to help account for the cost of the recent catastrophes to date as well as an expected rise in reinsurance premiums, [we] will be increasing base rates across Australia by 5 per cent and in QLD flood affected areas specifically by 20 per cent. We will also be introducing a flood risk loading based on postcode.

Similarly, in response to the catastrophic summer of 2010–11 another insurer implemented 'significant remedial actions/rate increases' across a number of its portfolios, including home insurance, in the 18 months following these events. These included effectively doubling rate increases previously effected for properties in northern Australia.

In 2011, a third insurer predicted that reinsurance costs were likely to increase by around 10 to 15 per cent as a result of the floods in Queensland, NSW and Victoria. They considered that in order to earn the increases in expenses and maintain their forecast profit margin, they needed to increase premiums for all home and contents products by five per cent across Australia.

To some extent these adjustments are understandable, as insurers will aim to maintain a profitable business with adequate reserves to meet future claims. However, it appears they were not necessarily made based on a technical reassessment of the forward looking cost of providing insurance (although changes to technical pricing would be expected to occur in time as a result of these events), but as a more immediate reaction to the cost of claims already made and their impact on insurers' profitability.

5.5 Calculating the final retail premium

Once the technical premium is determined and premium adjustments are applied, insurers apply any taxes, duties or levies imposed by governments. These include the GST, state and territory government stamp duties and levies, loadings for paying monthly rather than annually, and multi-policy, online and discretionary discounts. The following section looks at GST and other taxes before dealing with discounts and surcharges applied at the discretion of insurers.

GST, stamp duty and levies

The taxes and duties applied to general insurance premiums in Queensland, Western Australia and the Northern Territory over the last eleven years are shown in table 5.6 below. These are not a cost to the insurer, they are an added cost incurred by the consumer. Both are proportional to the premium, so the amount paid is higher in areas where premiums are higher.

A flat rate of 10 per cent GST is applied to all general insurance products across Australia. The stamp duty applied in Western Australia and the Northern Territory has been stable at 10 per cent over the eleven year period considered by the Inquiry. The rate of stamp duty applied in Queensland increased from 7.5 per cent to nine per cent on 1 August 2013.

Some jurisdictions currently, or have previously, imposed levies on insurers to contribute to the funding of emergency services. Insurers then recover the cost of the levies from their customers, typically with reference to the premium paid. Levies of this kind have not been imposed on insurance products in Western Australia, the Northern Territory and Queensland throughout the period under consideration.

This section generally refers to the GST, stamp duties and levies collectively as 'tax' for simplicity.

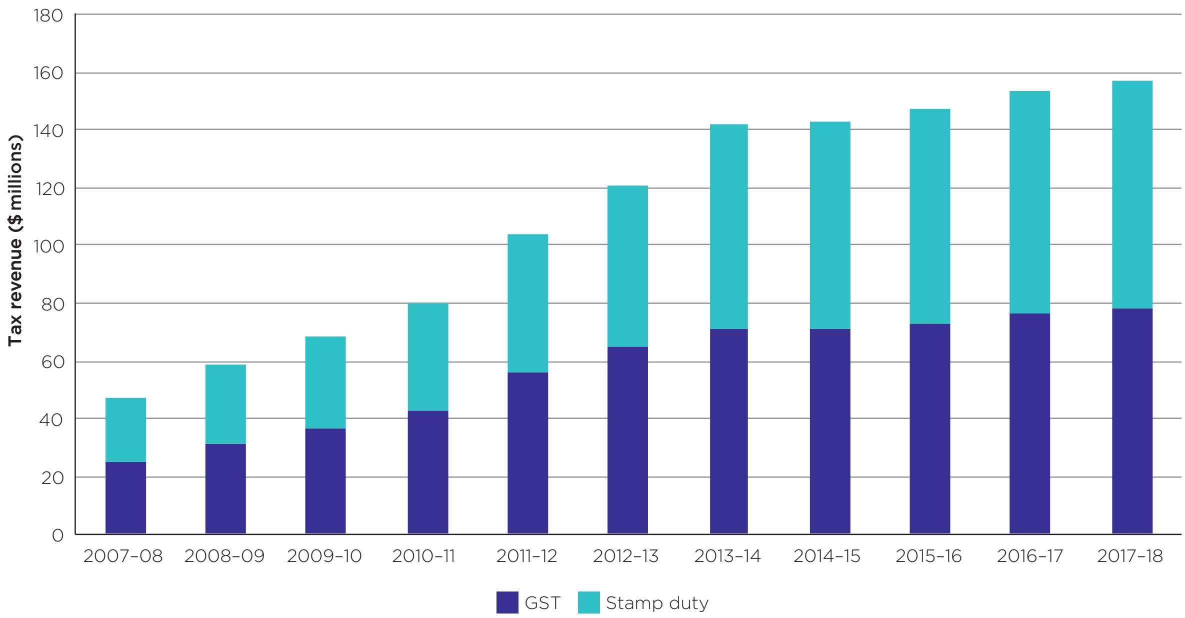
Table 5.6: Taxes on general insurance in Queensland, Western Australia, and the Northern Territory

	Queensland pre 31 July 2013	Queensland post 31 July 2013	Western Australia	Northern Territory
GST	10%	10%	10%	10%
Stamp Duty	7.5%	9%	10%	10%
Combined tax rate	18.3%	19.9%	21%	21%
Tax as a proportion of retail premium	15.4%	16.6%	17.4%	17.4%

As stamp duties are applied on the GST-inclusive amount of a premium, the effect of these duties is magnified. The taxes imposed on general insurance mean that premiums charged by insurers are magnified by 19.9 per cent in Queensland and by 21 per cent in the Northern Territory and Western Australia.

The total tax collected from home, contents and strata insurance in northern Australia has increased from $48 million to $157 million per annum over the 11 year period to 2017–18 in real terms, with tax revenue split evenly between stamp duty and GST.

Figure 5.10: Tax revenue (GST and stamp duty) from insurance in northern Australia, 2007–08 to 2017–18, real $2017–18



Source: ACCC analysis of data obtained from insurers.

In real terms, in 2007–08 the average amount of tax and levies applied to an insurance policy in northern Australia was $130. By 2017–18 this had increased to $315, broadly in line with the rise in premiums shown in chapter 3. In the rest of Australia, in 2007–08, the average amount was $163, rising to $196 in 2017–18. In 2007–08, most of the difference between northern Australia and the rest of Australia was due to the NSW Emergency Services Levy (ESL). The revenue requirement for this levy has not increased at the same rate as premiums (unlike GST and stamp duty) so its relative contribution has decreased over time.

The impact of taxes on consumers in northern Australia

The average figures presented above clearly show taxes have a significantly higher dollar impact on consumers in northern Australia than in other parts of the country. As taxes are proportional to premiums, the impact of taxes will vary across northern Australia in line with premium levels.

Using premiums as a basis for calculating stamp duties is administratively easy and will in general be an equitable approach to raising revenue. However, as shown above and elsewhere in the report, increasing estimates of claims costs and other factors have led to a substantial rise in average insurance premiums in northern Australia over the last decade. The move by insurers to more granular pricing has meant that these increases have been particularly large for consumers considered to be at a higher risk.

As such, the incidence of stamp duties has increasingly fallen on those consumers in higher risk locations regardless of their income. At the extreme, in 2017–18, consumers in the Whitsundays (the postcode with the highest average premiums for combined home and contents insurance) paid on average $2180 in GST and stamp duty alone. This compares with the average *total* premium in the rest of Australia in 2017–18 (including taxes) of $1337.

Several previous reviews have advocated for the abolishment of stamp duty on insurance contracts. For example, the Review of Australia's Future Tax System (also known as the 'Henry review') said 'all specific taxes on insurance products, including the fire services levy, should be abolished.'[67]

State and territory governments have not adopted such recommendations and are reluctant to forego the revenue they derive from these duties.

In October 2015 the ICA commissioned Deloitte Access Economics to write a report on the impact of removing stamp duty from insurance around Australia, and replacing the lost revenue with an increase in municipal land rates. The report found that removing all insurance-based stamp duties across Australia, including the Emergency Services Levy in NSW, and replacing them with commensurate increases in municipal land rates, would lead to a net increase in real private consumption across Australia of $5.52 billion, and a net increase in tax revenue collected by state and local governments of 0.69 per cent. These figures relate to a broad range of insurance products, not just home, contents and strata.[68]

We support the above recommendations of the Henry review and the Deloitte report and reiterate them in recommendation 1.

Recommendation 1: Abolish stamp duty on home, contents and strata insurance products

The governments of Western Australia, the Northern Territory and Queensland abolish stamp duties on home, contents and strata insurance products. State and territory revenue needs could be more equitably met through other means.

It has been widely acknowledged that stamp duties on insurance contracts are an inefficient form of taxation. This recommendation is in line with recommendations from previous inquiries into insurance and taxation issues.

Removing stamp duties from insurance products would result in meaningful reductions in insurance premiums for the residents of northern Australia. However, if stamp duties are maintained on insurance products, we also think there would be merit in state and territory governments considering the feasibility of amending the basis for their calculation away from retail premiums, towards some other metric.

The current method for levying stamp duty places a higher tax burden on someone living in a high risk property in northern Australia, compared to someone living in other parts of the state or territory. We consider that this unfairly penalises those living in higher risk areas.

A single rate per product (across the state/territory) may address affordability concerns in higher risk parts of northern Australia, but would also increase the incidence on those with lower sums insured in less risky (lower premium) areas.

67 Australia's future tax system: Final Report, Part 2: Detailed analysis, Chapter E: Enhancing social and market outcomes, 2 May 2010, p. 474.

68 Deloitte Access Economics: The economic impact of stamp duty: three reform options, December 2015.

A better alternative is to instead levy stamp duties with reference to the sum insured of a property, while remaining revenue neutral. This would have the effect of removing much of the effect of the relative risk of a consumer's property and offer some relief to consumers experiencing very high premiums in northern Australia and other areas.

Higher building costs and more stringent building standards mean that, for a property with certain characteristics, the estimated sum insured will be larger in northern Australia than in most other parts of the country. Despite this, average sums insured (under combined home and contents insurance products) in northern Australia are comparable to those in the rest of the country. As such, the incidence of stamp duties on residents of northern Australia would on average, be significantly reduced.

Introducing this in a revenue neutral way would result in a transfer of some of the tax burden from those with lower value but higher risk properties to those with higher value but lower risk properties.

The implementation of this approach will need to consider:

- the impact on consumers throughout the state or territory
- the administrative ease of the approach—we note that sums insured are already incorporated into the premium setting process of insurers at the same time they calculate stamp duty amounts currently
- the impact on future revenue growth from these duties
- the potential impact on the level of underinsurance and non-insurance.

As noted above, there has been a substantial growth in tax revenue from stamp duties in northern Australia over the period. While stamp duties on insurance products remain in place, especially in their current form, governments will continue to receive a significant amount of revenue from areas with higher insurance premiums. We consider that state and territory governments should consider dedicating some of this additional revenue to improving the affordability of insurance in northern Australia. This could take the form of a subsidy or other form of assistance for low income earners facing high insurance premiums. It could also be used to help fund mitigation measures that could reduce potential losses across a community (subject to the adoption of recommendation 14), or assist residents in overcoming the up-front cost barriers for household level mitigation described in chapter 11.

Recommendation 2: Re-base stamp duty; use stamp duty revenue for affordability & mitigation

If stamp duties on insurance are maintained, the Western Australia, the Northern Territory and Queensland governments should reduce their burden on consumers in higher risk areas by levying stamp duties for home, contents and strata insurance with reference to the sum insured value, rather than the premium level.

In any case, they should also direct a portion of revenue from stamp duties on insurance products towards measures to improve affordability for low income consumers or to fund mitigation works.

Re-basing stamp duty to be levied on sums insured will make it fairer to consumers living in higher risk areas.

Governments have previously received and continue to enjoy a windfall gain from the growth of insurance premiums in northern Australia. Directing revenue from stamp duties to public mitigation works should only be considered where insurers have provided estimates of premium reductions that would result from such works, and commit to reporting against these where work is undertaken (see recommendation 14).

Discounts and surcharges

There are a range of final discounts and surcharges that insurers can apply to determine the final retail premium.

Discounts can be given for the following:

- being a new customer
- being a longstanding customer (‘loyalty discounts’)
- not making a claim over a specified period (‘no claims bonus’)
- bundling insurance products from the same insurer
- purchasing the product online.

Insurers typically offer the same types of discounts, however the size of the discount varies. Discounts are often conditional on one or more criteria being met and may not be available to customers in all areas. Table 5.7 below provides an overview of the discounts offered by insurers in northern Australia.

Table 5.7: Discounts for key insurer brands, 2017–18

Brand	Being a new customer	Being a longstanding customer ('loyalty discount')	'No claim bonus'	Bundling home and contents into one product	Bundling with some other insurance product	Bundling with a home loan	Purchasing online
AAMI	–	–	–	10%	5% (first year)	–	$25 (single product) $50 (combined)
Allianz	0–13.5 %[69]	0–8.5%	10–30%	10%	–	–	10%
ANZ	–	1–7.5%	2.5–25%[70]	10%	7.5–12.5%	10%	–
APIA	–	–	–	10%	10%	–	15%
CommInsure	0–15% (limited time)	–	–	–	–	0–15%	0–15%
NRMA	–	5–15%	5–25%	2.5–15%[71]	2.5–15%[72]	–	–
QBE	–	1–7.5%	2.5–25%[73]	$21	10%	–	–
RACQ	–	2.5–17.5%	0–6%	0–13%	5%	15%[74]	$75
Suncorp	–	–	–	–[75]	15% (min. of 3 products)	0–20%	$50 (single product) $100 (combined)
Westpac	5–15%	–	5–15%	10%	–	10%	17.2% (for new customers)
Youi	–	–	0–20%[76]	–	20% (contents)	–	10% (for new customers)

Source: Information obtained from Insurers.

These discounts can be offered to encourage or recognise actions that lower costs for the insurer. This may be in the form of lower administrative costs (for example bundling or online discounts), claims and claims handling costs (for no claims bonuses). They are also used to attract and retain customers (new customer and bundling discounts).

The use of discounts for competitive purposes is considered further in chapter 7.

Insurers can also apply surcharges on premiums. Some, but not all insurers, will include a premium surcharge for consumers who pay by the month. These surcharges are discussed in chapter 8.

69 Depending on product and location.

70 Also subject to capping and collaring.

71 Depending on the length of the relationship with NRMA. This is a subset of the "bundling with some other insurance product" offer.

72 Depending on number of policies and length of relationship with NRMA. Can be combined with the loyalty discount for a maximum reduction across the two discounts of 25%.

73 Also subject to capping and collaring.

74 A discount of 100% was also offered for a limited time only.

75 Home and contents count as two policies for determining the multi-policy discount.

76 Not an explicit discount, range calculated based off comparing premiums for the same policy with and without claims.

5.6 Summary of how insurers set premiums

Technical pricing

From the information obtained during the inquiry so far, it does not appear that insurers are unreasonably inflating technical premiums in northern Australia. Instead, it appears that insurers are attempting to set technical premiums in a way which, in their view, accurately reflects the risks they are insuring, and thereby the cost to supply insurance in northern Australia. AGA also reviewed insurers pricing methodologies and did not find evidence to suggest that the insurers' approaches to setting the technical premium are unreasonable.

Setting a technical premium is complex, and for expected catastrophe claims in particular, involves a great deal of uncertainty. Insurers' changes to their pricing models over the period have primarily been intended to improve their ability to estimate claims costs by incorporating more accurate data and sophisticated risk assessment methodologies.

One of the reasons for higher premiums in northern Australia is that the expected catastrophe costs are higher than in the rest of Australia leading to higher technical premiums. Cyclone risk in particular appears to be contributing to high premiums for many consumers as the risk is widespread in northern Australia. Further, as cyclone losses can be high, the cyclone component of the technical premium can be significant in many parts of northern Australia. In addition for a smaller portion of consumers in northern Australia, the flood component is also a contributor to high premiums. In contrast, the component of technical premiums for perils facing the rest of Australia are generally far smaller. Further, due to the higher expected catastrophe claims in the area, the reinsurance cost component of the technical premium in northern Australia is also much higher.

The increased focus on the expected catastrophe cost component of technical premiums, and the introduction of flood cover, also appears to have contributed to increasing premiums in northern Australia. As pricing methodologies have become more sophisticated, it appears that the estimated cost of claims from cyclone and floods has increased for high risk policies (and fallen for lower risk policies). In addition, the increasing granularity of insurers pricing methodologies, has contributed to the increase in the number of consumers paying very high premiums.

As illustrated above, we observed a common trend across insurers of a move to a more granular assessment of claims costs for catastrophes over the last decade. This increasing granularity of premium calculation does lead to a more accurate rating of individual risks, and has reduced historical cross subsidisation between policyholders.

A number of insurers stressed the importance of this in submissions, and it was also demonstrated in their internal documents which set out reasons for moving to more granular pricing. For example, in its submission Suncorp stated:

> It is important to apply different prices for different risks to ensure we offer accurate prices and collect enough premiums to pay future claims…insurers now price at a much more granular level… This has the effect of removing cross-subsidies…The removal of the cross subsidy provides a strong price signal of the inherent risk of an individual property.[77]

Similarly Allianz submitted in relation to risk rated premium:

> Commercially, an insurer has no choice in the matter..An insurer that suffers from anti-selection because it community rates its premiums…will retain its less profitable (or loss making), higher risk customers and lose its more profitable, lower risk customers to its risk rating competitors.[78]

We understand the importance of more granular risk ratings for insurers. However, the move to a more granular approach to modelling and pricing for catastrophe risk has meant that some groups of consumers in northern Australia and elsewhere now face considerably higher premiums, as illustrated in chapter 3.

77 Suncorp submission, p. 16.

78 Allianz submission, p. 5.

Insurers' approaches to technical pricing are continually evolving, and we will continue to monitor these as the inquiry progresses.

Premium adjustments

Adjustments made to technical premiums often reflect reasonable commercial strategies of the insurers driven by an insurers' profit, growth and risk management objectives.

Where insurers see risks as attractive, premium adjustments can benefit consumers. For example, through reduced premiums to win market share. However, other premium adjustments are motivated by the actual or expected higher costs resulting from the risk profile of an insurer's customer base in aggregate, however the magnitude of the adjustments may not precisely reflect these costs. These adjustments can increase premiums for some consumers, sometimes significantly.

In higher risk areas or areas where they have a sizeable market share, insurers often do not seek to win market share, and instead look to reduce their exposure. Here, premium adjustments often appear to be exacerbating affordability pressures. Risk concentration and competitor pricing adjustments in high risk areas are leading to premiums which are potentially much higher than consumers' technical premiums.

Such adjustments represent decisions by insurers to actively price themselves out of a segment of the market. Premiums are increased to either slow or stop new business, or to discourage existing customers from maintaining their coverage. At the extreme, an insurer may elect to withdraw from the area completely.

To the extent that affected customers switch to other insurers, those other insurers are then more likely to make (or extend) similar premium adjustments. In these areas, insurers are not seeking to win market share as we would often expect in competitive markets. There is clearly the potential for such adjustments to eventually drive many consumers from the market altogether.

This dynamic is more likely in parts of northern Australia with fewer active insurers to whom risks can be transferred and where those insurers present are likely to have a higher concentration risk and level of exposure.

The application of premium adjustments (which are unrelated to the individual risk of a property) can also distort the price signals that insurance premiums send to consumers and the public generally regarding their risks (as opposed to the insurer's risks). Such price signals are often cited in support of more granular pricing approaches. Technical premiums in northern Australia are already higher on average than in the rest of Australia. On top of this, a number of premium adjustments can combine to lead to even greater affordability issues for consumers living in higher risk parts of northern Australia. It is possible that the use of adjustments means that in some cases retail premiums could be higher than technical premiums.

We will be examining premium adjustments across northern Australia in 2019, to more closely examine the impact that they are having on northern Australian insurance markets.

Focus area 3: Examination of premium adjustments

We will further examine the use of premium adjustments by insurers operating in northern Australia. In particular, we will consider:

- **the scale of premium adjustments and their potential to distort price signals to consumers regarding risks**
- **the potential impact of adjustments employed to manage concentration risk and exposure, on higher risk consumers**
- **the extent to which insurers are discriminating between new and existing customers through premium adjustments.**

This will help us to determine the extent to which premiums could be lower in northern Australia, and to consider whether there are ways in which the impact of these adjustments on higher risk consumers could be lessened.

6. Profitability of insurers in northern Australia

Key points

- Profitability metrics indicate that while the region remains largely unprofitable, performance has improved over the period since 2007–08. From 2007-08 to 2012–13, insurers incurred an aggregate loss inclusive of investment returns of approximately $570 million (real $2017–18) in northern Australia, while the most recent five year period to 2017–18 provided an aggregate loss of approximately $57 million.
- Some insurers generated a small positive profit margin over the 11 year period, however the margin was lower than their corresponding performance for the rest of Australia.
- Insurers' financial performance in northern Australia over the 11 year period to 2017–18 is inferior compared to both whole of Australia and global general insurance metrics.
- Compared to the rest of Australia, northern Australia is underperforming for each specific product line.
- In northern Australia and the rest of Australia, the profitability of contents insurance substantially exceeds profitability of home and strata insurance.
- Home insurance is the worst performing product line in northern Australia with a net loss ratio on average over the 11 year period of 97 per cent in northern Australia versus 77 per cent for the rest of Australia.
- Insurer level profitability is generally consistent with the aggregated analysis by region and product. Performance is generally inferior compared to the rest of Australia although there has been an improvement in the ratios over the last five years.

This chapter sets out our approach to assessing insurer profitability in northern Australian markets and the challenges in doing so given data limitations. We consider various metrics for assessing profitability before applying these at the regional, product and insurer level. We also make profitability comparisons with the rest of Australia, for general insurance category as a whole in Australia, and internationally.

6.1 Our approach to assessing insurer profitability

Understanding the profitability of supplying insurance in northern Australia is important for evaluating the health of the sector. Striking an appropriate balance between insurer profitability and consumer access to affordable insurance requires insurers to be both sufficiently profitable and financially sound, but not excessively profitable in relation to the underlying risk.

Property insurance is characterised by periods of 'soft' market conditions, in which premium rates are stable or falling and insurance is readily available, and by periods of 'hard' market conditions, where premiums and reinsurance rates rise, coverage may be more difficult to find and insurers' profits begin increasing.[79] The insurance products covered by this inquiry, are akin to most insurance markets in that they are also cyclical in nature, shifting between these hard and soft market conditions.[80]

This cyclicality complicates the use of premiums or profits to assess market power in the industry. Market power can be defined in terms of a firm's ability to raise prices consistently and profitably above competitive levels. This is based on the idea that in a perfectly competitive market, prices are set at the level of cost, where cost includes a 'normal' profit margin to cover the cost of having to provide a return to providers of capital to cover the risk they incur. In contrast, in less competitive markets prices are set in excess of the level of cost. Therefore, in theory, one way to assess whether a firm has market power

79 More information on insurance cycles can be found at the Insurance Information Institute www.iii.org/publications/commercial-insurance/how-it-functions/market-conditions-cycles-and-costs.

80 A prominent international example of this is the impact of the 2005 hurricane season and in particular hurricane Katrina in the United States. The outcome of these weather events was a hard market with reduced underwriting capacity and rising premiums. This encouraged a raft of new entrants into the reinsurance market known as the 'class of 2005' who anticipated rising rates following the catastrophic events.

and/or the market is less competitive is to assess whether the firm or industry has been making profits in excess of the 'normal' return for the riskiness of the firm or industry.

This can be hard to do empirically due to difficulties obtaining relevant data, the cyclical nature of insurance and assessing risks which are challenging to measure, and vary across geographic regions.

Here we do not attempt to directly estimate the 'normal' return for insurers in northern Australia. Instead we do two things:

- We use other parts of the insurance industry as comparators:
  1. the rest of Australia (outside of northern Australia) for home, contents and strata
  2. the whole of Australia for general insurance
  3. global performance statistics for general insurance.

  None of these are perfect comparators, but they all have at least some comparability and generally have a similar risk profile. We do this using a set of standard profitability measures including gross profit, profit margin, gross and net loss ratios, combined ratios and underwriting results.
- We look for significant differences in profitability across regions and products within northern Australia. We do this to understand the industry, and potentially help provide direction for further investigation or consideration on competition issues in those segments. We use the same profitability measures outlined above.

The profitability measures we have used

Previous inquiries and reviews covering insurance in northern Australia were unable to collect financial data to a detailed regional and product level of disaggregation. Insurers have not typically reported standard financial information for internal or external reporting purposes in the geographical subsets we are considering here. As part of their responses to our request for information, insurers have in most cases been able to reasonably allocate relevant revenues and expenses across products and regions. This has facilitated the ability to apply standard insurance profitability measures for northern Australia in a way which was not previously possible.

Insurer profitability is affected by both the performance of insurance operations and by the return on investments of insurance assets. Operating performance is assessed using standard ratios used by the insurance industry that compare combinations of incurred claims and expenses to various premium measures. These standard ratios either include or exclude the effect of reinsurance and of underwriting expenses, providing insights into different aspects of the insurance operations.

The measures used here are:

- **Profit or (loss):** Nominal profit or loss before tax prepared in a format consistent with APRA general reporting standard (GRS) 310.[81] Typical elements that are included but are not limited to; gross earned premium[82], reinsurance expense, claims paid, movement in loss reserves, reinsurance recoveries, underwriting expenses, commissions, investment income and other income and expenses.
- **Profit margin:** Profit or (loss) divided by gross earned premium.
- **Gross Loss Ratio (GLR):** Ratio of gross incurred claims[83] to gross earned premium. The gross loss ratio provides a view on profitability exclusive of reinsurance and underwriting expenses (such as acquisition costs and commissions). As an example, an insurer with $6 million of gross incurred claims and $10 million of gross earned premium over a period of time would have a gross loss ratio of 60 per cent. The gross loss ratio is an indicator of the profitability of the product itself, unaffected by how profits are split between the primary insurer and reinsurers.

81 Underwriting expenses for the purpose of this inquiry excluded any impact from liability adequacy tests.

82 Gross earned premium is gross written premium adjusted for premium which is unearned during the period, and it excludes GST, levies and stamp duty.

83 Gross incurred claims are claims paid plus movement in outstanding loss reserves.

- **Net Loss Ratio (NLR):** Ratio of net incurred claims to net earned premium. The net loss ratio is the GLR adjusted for the impact of reinsurance premiums and reinsurance recoveries on claims. This ratio is an indicator of the profitability of the product inclusive of reinsurance, but not including underwriting expenses.
- **Combined Operating Ratio (COR):** Net incurred claims plus underwriting expenses, as a proportion of net earned premium. This is equivalent to the sum of the NLR and expense ratio. The COR provides one of the most complete performance metrics as it incorporates all the above ratios. The COR does not include investment returns or other non-underwriting income and expenses. Insurers with CORs which marginally exceed 100 per cent can remain profitable overall, depending on the returns on their related investment portfolios.

Each measure identified above provides a different insight into profitability. Examining each measure in aggregate, over time, and by product and sub-region provides a more complete understanding of the drivers of profitability.[84] They facilitate a comparison of the financial performance of northern Australian insurers against insurer profitability in the rest of Australia, world-wide and against other comparators.

Some other common performance measures such as return on assets or return on equity are not readily available at the product or sub-region level. This is because an insurer's balance sheet is not split by products or sub-regions, and investment returns are not ordinarily allocated to the particular product or region providing the funds invested due to most having a strong operational focus on profitability and risk at the portfolio level.

84 One limitation of these measures is that they do not directly consider the scale of the insurer's operations in underwriting or investment. We provide indications of scale at relevant points in the text.

Box 6.1 Decreasing return on investments

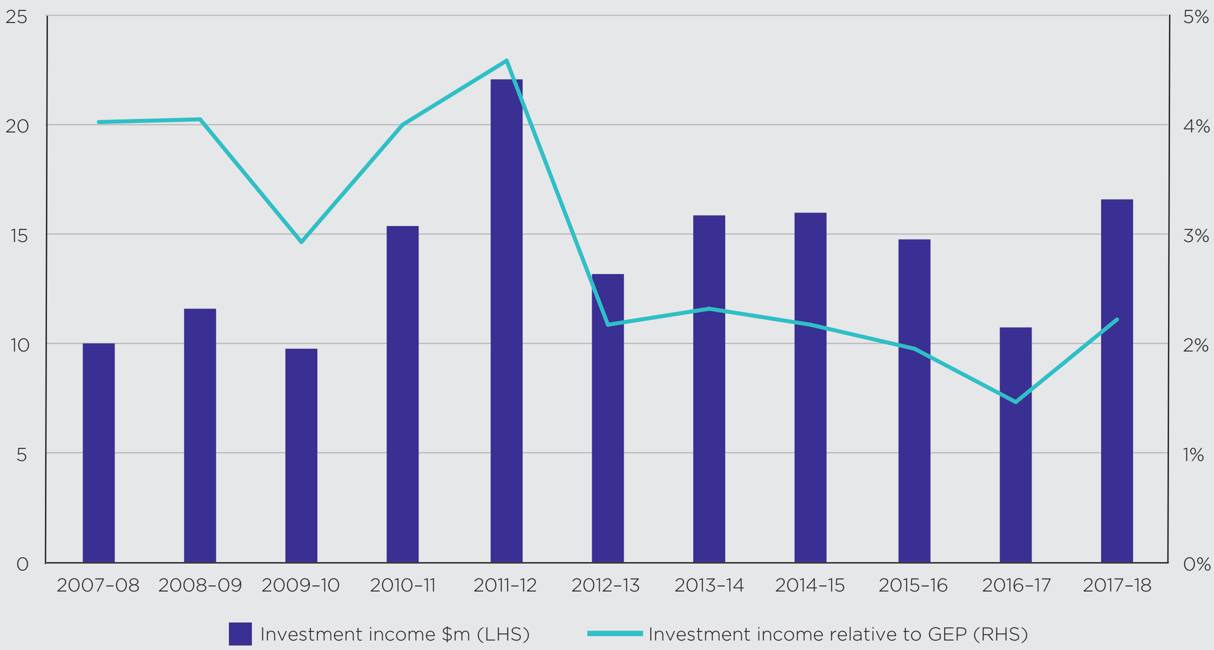
A key component of an insurer's business model is to invest premium in order to support the fulfilment of claims and future profitability of the company. Investment returns can be a significant source of revenue for insurers and is incorporated into the gross profit and profit margin data presented in this chapter. However, investment returns do not feature in gross and net loss ratios.

Investment portfolios of Australian insurers primarily consist of fixed income securities including government and corporate bonds. The Australian cash rate has declined substantially over the eleven years in focus of the inquiry from 6.25 per cent at the start of the 2008 financial year to 1.5 per cent in 2018. This is consistent with global trends in interest rates over the same period.

As expected from the decline in interest rates, investment income as a proportion of gross earned premium has steadily declined throughout the period. The performance of an insurer's investments is not particular to northern Australia, and accordingly this has not been subject to further examination.

Insurers' investment revenue allocated to home, contents and strata product portfolio is set out in figure 6.1 below, and is also presented as a percentage of gross earned premium.

Figure 6.1: Investment income allocated to northern Australia for all insurers and products, and compared to gross earned premium, 2007–08 to 2017–18, real $2017–18



Source: ACCC analysis of data obtained from insurers.

The time scales we have used

Insurance offerings which include cover for catastrophe risks are highly unpredictable over the short term. For this reason, profitability is preferably monitored over extended periods of time rather than for individual years. The timeframe observed by this inquiry is substantial and spans a period where there were both substantial increases in premium and large weather events.

To understand the broader trends in profitability, we have utilised performance metrics and calculated these over three different averaging periods; an average over the eleven years from 2007–08 to 2017–18, the six year period from 2007–08 to 2012–13 and the last five years from 2013–14 to 2017–18. These blocks of financial years were selected to split the eleven years into two substantial time periods. As noted elsewhere in this paper, viewing profitability for insurance which include catastrophe protection is best done over multiple periods rather than individual years.

Data sources, assumptions and caveats

The insurer and industry data utilised in this report was primarily obtained using our information gathering powers under section 95ZK of the CCA as set out in chapter 1. Information was also obtained from Zurich and Defence Services Homes Insurance. It was collated and analysed with the assistance of the Australian Government Actuary (AGA).

Financial data was obtained for each region of northern Australia: north Queensland, the Northern Territory and the north of Western Australia. For many cost and some revenue items, insurers do not record financial data at a regional level, or split by product type.

As such, the profitability metrics presented here for northern Australia are based on revenue and expense allocations prepared by insurers for the purpose of this inquiry, in consultation with the ACCC and the AGA.

Allocations were prepared by insurers in most cases with a current view on risk. It is possible that the outcome of this may differ from the view which was in existence in the financial year which is subject to the allocation.

The financial data was not prepared for statutory or prudential reporting, and has not been subject to independent external audit.

The ACCC is reliant on the accuracy of financial data submitted by insurers. All references to years are for the financial years ending 30 June of that year, and profit is reported pre-tax in real $2017–18.

6.2 Profitability in northern Australia has been poor but is improving

For the years 2008 to 2018, insurers in northern Australia are estimated to have experienced an aggregate loss across home, contents and strata insurance products of approximately $627 million in real $2017–18.

Other profitability metrics for the period are consistent with this outcome and indicate that financial performance was sub-par. This includes:

- an overall GLR[85] of 80 per cent in northern Australia, compared to 61 per cent in the rest of Australia, over the 11 year period. For home insurance a GLR of around 60 to 65 per cent might be regarded as indicating broadly adequate premium rates. Higher loss ratios than this might be regarded as indicating inadequate premium rates.[86]
- an overall NLR[87] of 89 per cent in northern Australia, compared to 67 per cent in the rest of Australia, and
- CORs[88] as an average for all insurers in northern Australia that substantially exceeded 100 per cent in years of heavy catastrophe activity, particularly resulting from tropical cyclone Yasi and flooding in Queensland in 2011.

Insurers have implemented substantial changes over the eleven year period which have had a direct impact on profitability. This includes but is not limited to, flood inclusions, new and updated technical models and data, market adjustments to pricing (for concentration risk and in response to competitors), and other general and targeted premium increases.

While profitability over the eleven year period has generally been sub-par, there are indications of improving performance in the last five financial years from 2014 to 2018, possibly as a result of the activities mentioned above, and variations in catastrophe events.

85 The gross loss ratio is the Gross incurred claims (current and prior years) (net of non-reinsurance recoveries revenue) divided by Gross earned premium.

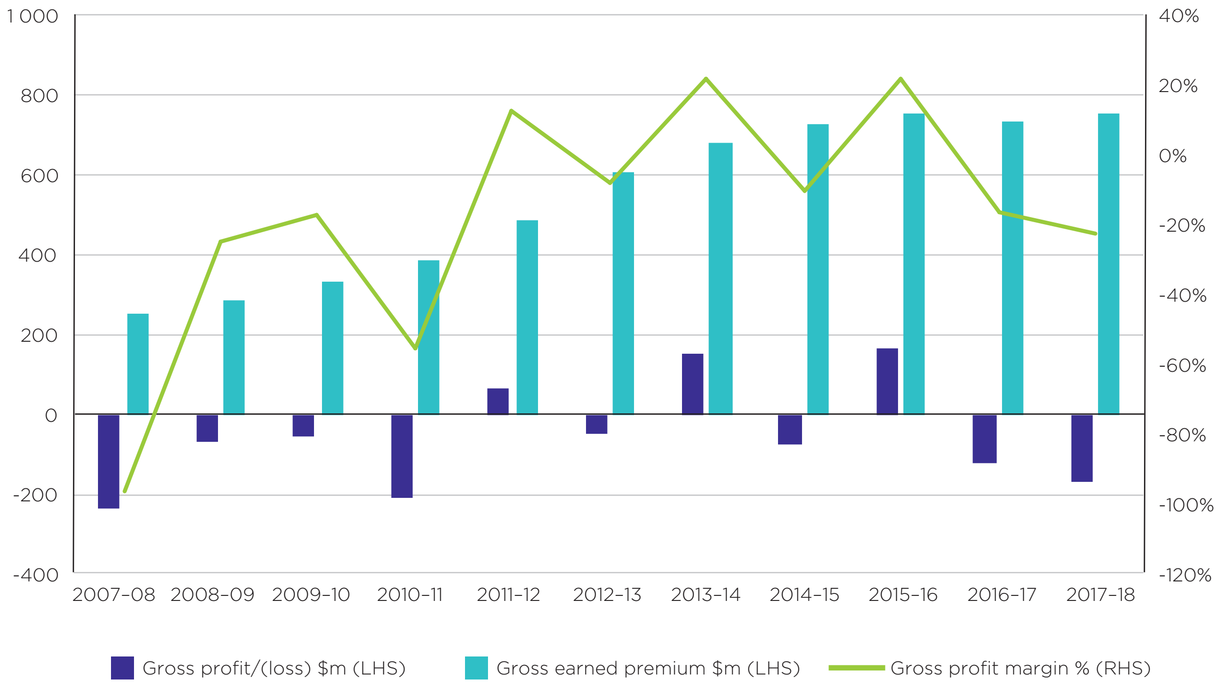
86 Australian Government Actuary, *Report on home and contents insurance prices in North Queensland*, 2014, p. 12.

87 The net loss ratio is Net incurred claims (current and prior years) divided by Net earned premium.

88 The combined ratio is the Net incurred claims (current and prior years) plus Underwriting expenses divided by Net earned premium.

The inherent nature of catastrophe cover is that it has high variability in claims costs and therefore profits. Accordingly, monitoring performance over longer timeframes is more meaningful. This high degree of variability is observed in figure 6.2 which reveals the profit margin fluctuating between minus 96 per cent and 22 per cent over the period.

Figure 6.2: Northern Australia estimated gross profit, gross earned premium and profit margins, 2007–08 to 2017–18, real $2017–18



Source: ACCC analysis of data obtained from insurers.

For the years 2008 to 2018, insurers in northern Australia are estimated to have experienced an aggregate loss across home, contents and strata insurance products of approximately $627 million in real $2017–18.

Profitability in northern Australia appears to have improved subsequent to the period from 2008 to 2013, which experienced an estimated aggregate loss of $570 million. This recent five year period has a gross earned premium of $3.6 billion, estimated loss of $57 million and an implied profit margin of minus 1.6 per cent.

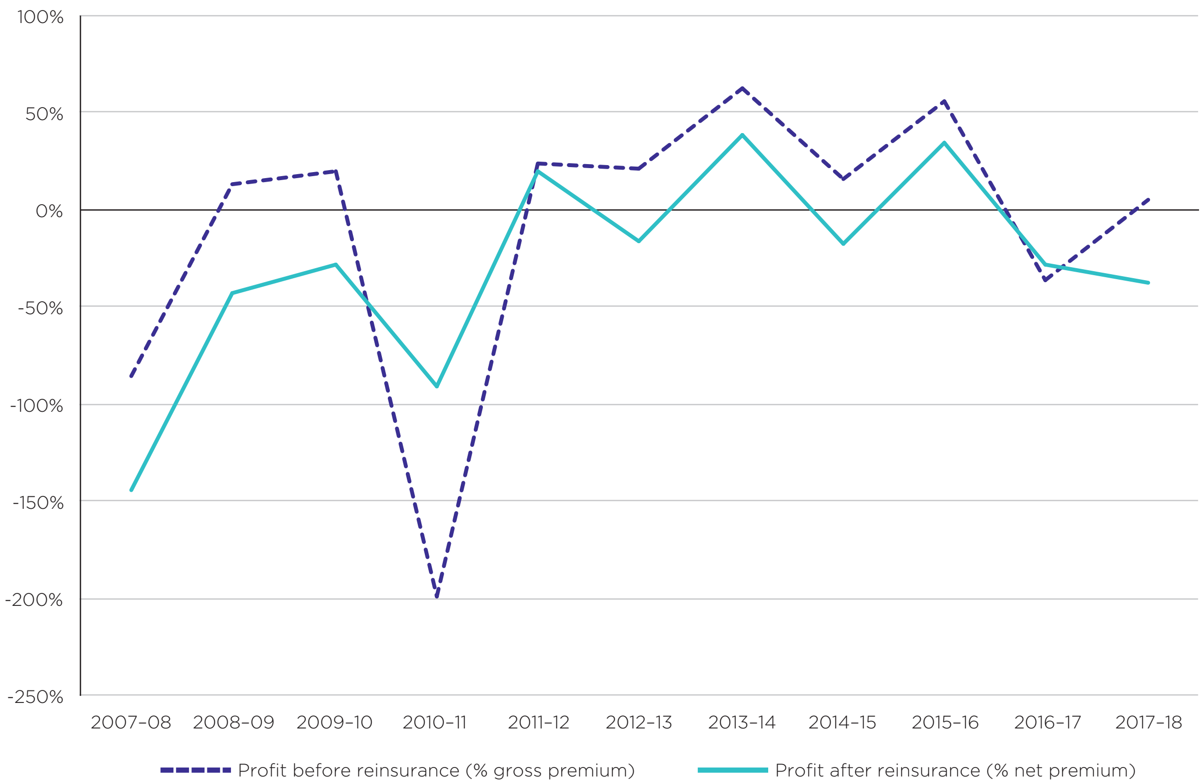
The GLR averaged 80 per cent over the 11 year period, which is higher than the generally accepted range of 60 to 65 per cent necessary for adequate profitability.[89] Similarly the NLR (which also incorporates both the cost and benefit of reinsurance) was high at 89 per cent for the period.

The COR for the 11 year period was 121 per cent, which is a further sign of the negative performance for insurers in northern Australia noted above, but also reveals some improvement in profitability in recent years with the average combined operating ratio of 145 per cent for the period to 2013 falling to a more sustainable level of 108 per cent for the final five years to 2018.

Figure 6.3 below also illustrates the general profitability trend over the eleven year period both pre and post the impact of reinsurance.

89 Australian Government Actuary, *Report on home and contents insurance prices in North Queensland,* 2014, p. 12.

Figure 6.3: Profit before and after reinsurance (per cent of gross and net earned premium), 2007–08 to 2017–18



Source: ACCC analysis of data obtained from insurers.

6.3 Northern Australia is less profitable than the rest of Australia

Insurers have made an estimated profit of $6.9 billion from home, contents and strata insurance in the rest of Australia, on gross earned premium of $61 billion, at a profit margin of 11 per cent. Both the estimated profit and profit margin are significantly higher for the rest of Australia than for northern Australia as shown in table 6.1 below.

Table 6.1: Profit and profit margin

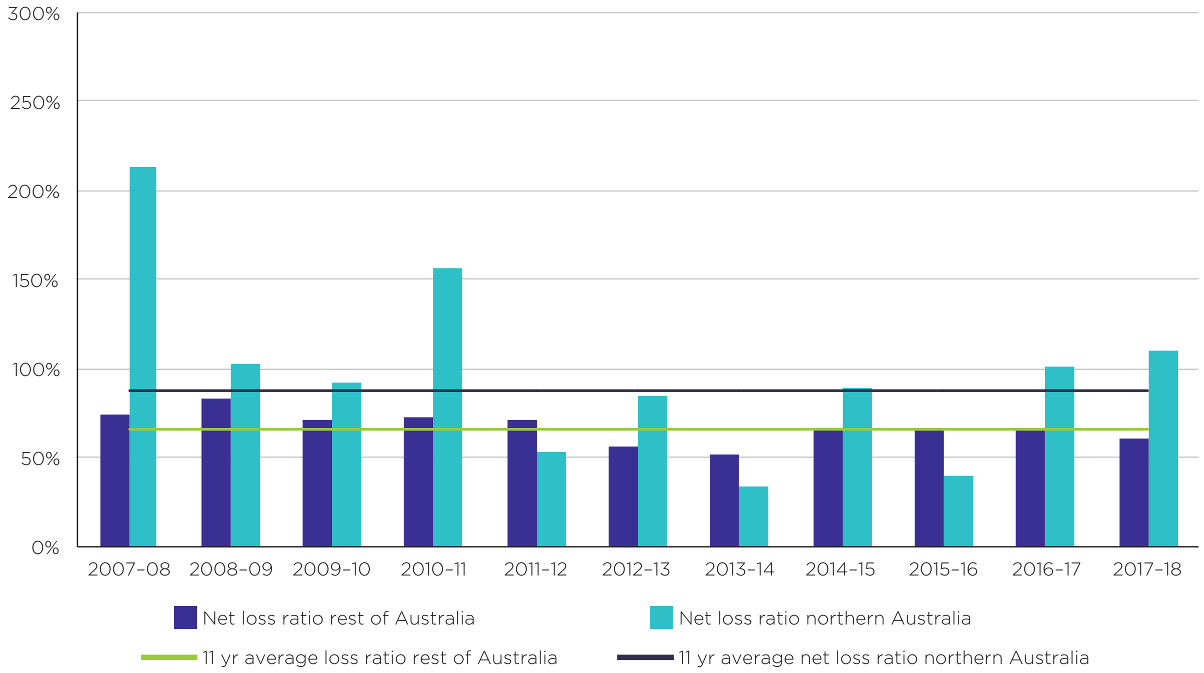
Region	Northern Australia		Rest of Australia	
	Profit (loss) $m	Profit margin	Profit (loss) $m	Profit margin
2008 to 2018 total	(627)	(10%)	6 870	*11%*
of which 2008 to 2013	*(570)*	*(24%)*	*2 968*	*11%*
of which 2014 to 2018	*(57)*	*(1.6%)*	*3 902*	*12%*

Source: ACCC analysis of data obtained from insurers.

Average GLR and NLRs also provide an indication of the relatively poor profitability of insurance in northern Australia. The average GLR for the eleven year period was 80 per cent, which is 19 percentage points higher than for the rest of Australia.

The NLR (inclusive of reinsurance costs and recoveries) shown below in figure 6.4 for northern Australia and for the rest of Australia reveals both greater volatility and a higher average ratio for northern Australia compared to the rest of Australia. Specifically, the data indicates that the NLR is 22 percentage points higher in northern Australia than for the rest of Australia.

Figure 6.4: Net loss ratios in northern Australia, 2007–08 to 2017–18



Source: ACCC analysis of data obtained from insurers.

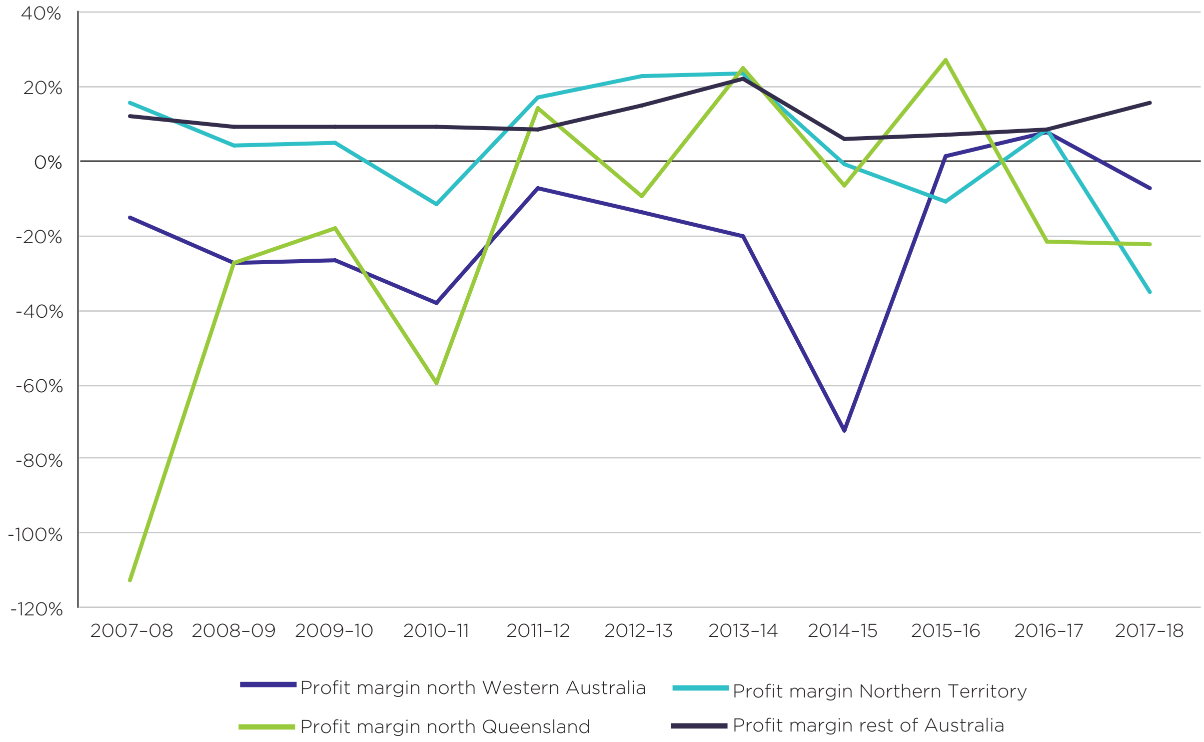
Natural disasters, specifically cyclones, are one factor that contributes to the volatility in the net loss ratios, illustrated above. Also, the smaller size of insurance markets in northern Australia relative to the rest of Australia is likely to be a contributing factor to the differences in volatility observed between the two regions.

6.4 Profitability varies significantly by region, product and insurer

Profitability per region

For the eleven year period, northern Queensland contributed an estimated overall loss of $535 million on $5.2 billion of gross earned premium at an average margin of minus 10 per cent. The Northern Territory region had an estimated overall loss of $13 million on $416 million of gross earned premium at a margin of minus three per cent. For north Western Australia the total overall loss for the period was estimated at $79 million on $411 million of gross earned premium at a margin of minus 19 per cent. Figure 6.5 illustrates the profit margins per region over the period.

Figure 6.5: Profit margin per region, 2007–08 to 2017–18



Source: ACCC analysis of data obtained from insurers.

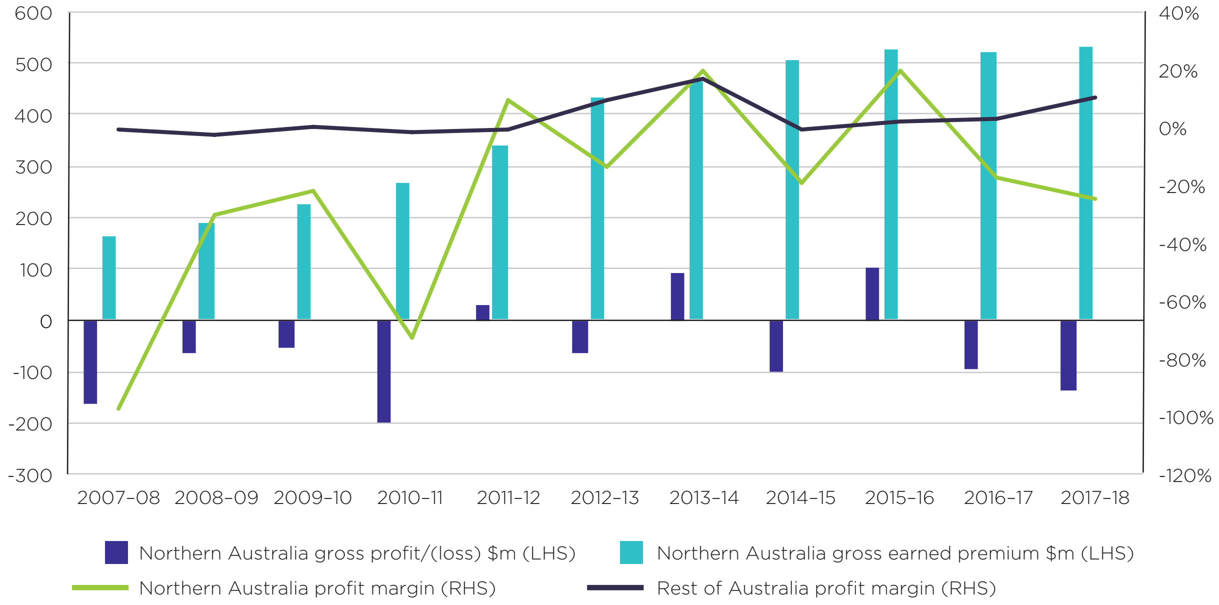
Profitability by product

Over the eleven year period it is estimated that insurers incurred a loss of $627 million. However, the estimated profitability of the insurance product types varied: home insurance is estimated to have an overall loss of $610 million and strata insurance a loss of $47 million in northern Australia, while contents insurance is estimated to have made a profit of $31 million across the industry. The profitability of each type of product is considered below.

Home insurance

Figure 6.6 reveals the gross profit or loss attributable to home insurance both in northern Australia and for the rest of Australia. Consistent with the performance metrics for all products combined, a general improvement in profitability was evident over the eleven year timeframe. A loss of $610 million is estimated for the eleven year period, however $486 million was attributable to the financial years 2008 to 2013 whereas the final five years generated a smaller loss of $124 million. The overall profit margin for this type of insurance over the 11 year period is relatively low with minus 15 per cent in northern Australia and four per cent in the rest of Australia.

Figure 6.6: Home insurance profit, earned premium and profit margins, 2007–08 to 2017–18, real $2017–18



Source: ACCC analysis of data obtained from insurers.

For the whole of northern Australia the GLR for home insurance over the eleven years is 17 percentage points higher than for the rest of Australia and 20 percentage points higher for the NLR. This is predominantly caused by north Queensland which also has an average NLR of 97 per cent during the period. North Queensland results are severely impacted by the 2008 and 2011 financial years which included multiple catastrophe events. It is evident that the loss ratios are also more volatile than for the rest of Australia.

Consistent with the aggregate product view noted earlier, there appears to be a trend towards improving profitability, shown by a decrease in the loss ratios. The average NLRs in table 6.2 are reducing in the last five years and are moving closer to those in the rest of Australia.

Table 6.2: Net loss ratio

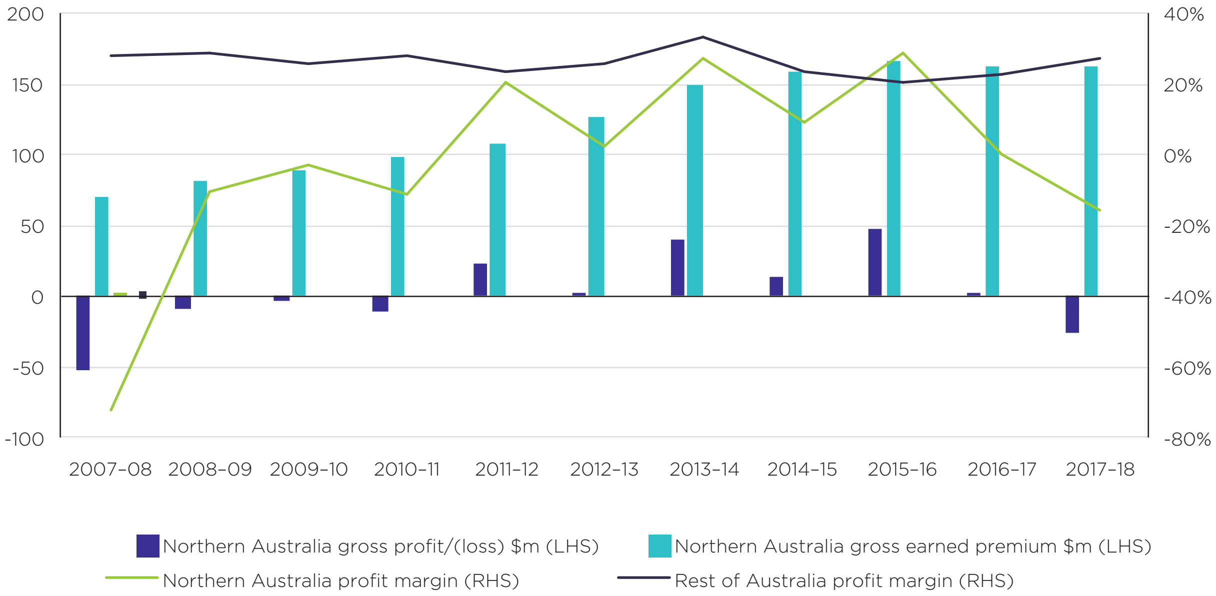
Region	11 year average	Avg. 2008 to 2013	Avg. 2014 to 2018
Northern Australia	97%	119%	84%
Rest of Australia	77%	83%	73%

Source: ACCC analysis of data obtained from insurers.

Contents insurance

Figure 6.7 displays the gross profit or loss attributable to contents insurance both for northern Australia and the rest of Australia. Consistent with performance for the combined product view, a general improvement in profitability was noted over the period. A gross profit of $31 million in northern Australia is estimated for the eleven year period, however a loss of $48 million was attributable to the financial years 2008 to 2013. In contrast, the period from 2014 to 2018 generated an estimated profit of $79 million. The overall profit margin for this type of insurance is relatively high at 26 per cent on average for the period in the rest of Australia compared to two per cent in northern Australia.

Figure 6.7: Contents insurance profit, earned premium and profit margins, 2007–08 to 2017–18, real $2017–18



Source: ACCC analysis of data obtained from insurers.

For the whole period the GLR for contents insurance in northern Australia are higher than the rest of Australia. The average GLR is 62 per cent in northern Australia compared to 45 per cent for the rest of Australia. Similar to home insurance, this is heavily influenced by the catastrophe events of 2008 in Queensland. GLRs in this range are considered to be reasonable and indicate that contents insurance is profitable.

The trend of improving profitability is also indicated in the NLRs over the period per Table 6.3. There is a clear margin between the NLR in northern Australia and the rest of Australia in the early years of this inquiry. However, in the last five years the ratio for northern Australia is trending towards the ratio in the rest of Australia.

Table 6.3: Net loss ratio

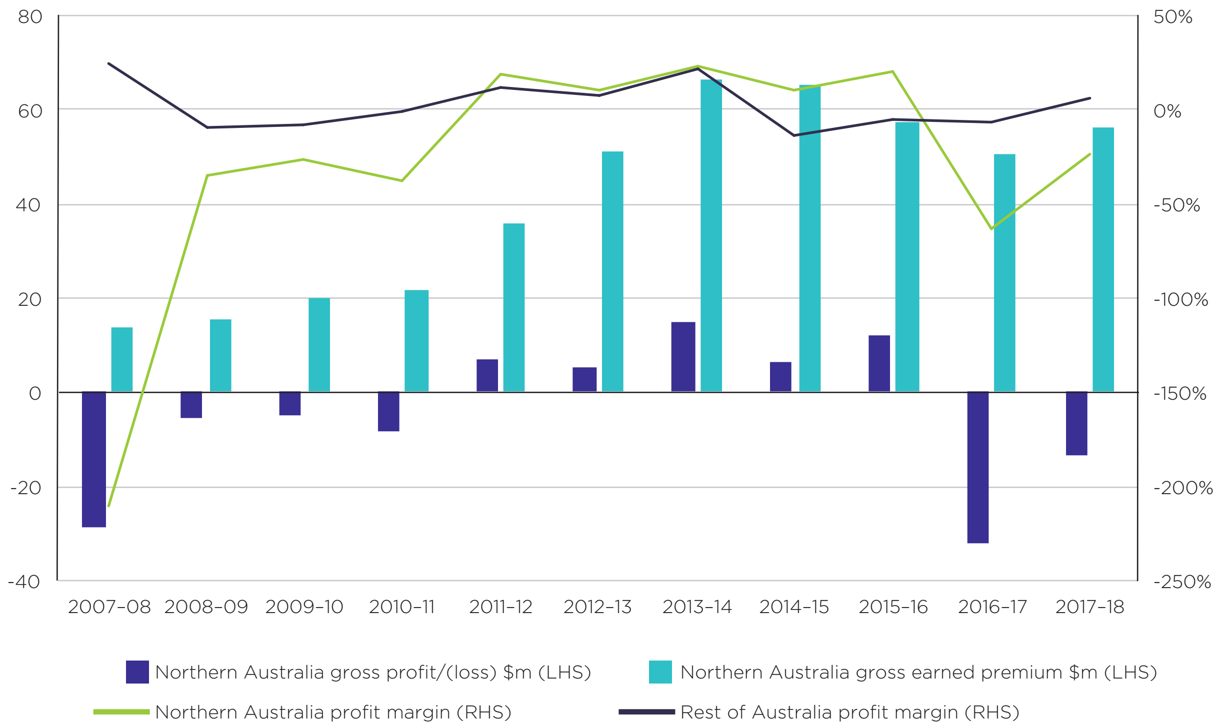
Region	11 year average	Avg. 2008 to 2013	Avg. 2014 to 2018
Northern Australia	69%	81%	61%
Rest of Australia	50%	53%	47%

Source: ACCC analysis of data obtained from insurers.

Strata insurance

For the eleven year period in northern Australia, strata insurers incurred an estimated loss of $47 million at a margin of minus 10 per cent. Figure 6.8 displays the breakdown of this financial loss between periods and compared to the rest of Australia.

Figure 6.8: Strata insurance gross profit, earned premium and profit margin, 2007–08 to 2017–18, real $2017–18



Source: ACCC analysis of data obtained from insurers.

The eleven year average GLR for strata insurance of 67 per cent is considered to be high when compared with 56 per cent in the rest of Australia.

The NLR in table 6.4 also indicates sub-par profitability of strata insurance in northern Australia. The NLR for the period is substantially higher than for the rest of Australia at 80 per cent versus 64 per cent. The reason for the difference between the GLR and NLR is the estimated cost of reinsurance exceeding the estimated benefit from reinsurance recoveries during the period.

Table 6.4: Net loss ratio

Region	11 year average	Avg. 2008 to 2013	Avg. 2014 to 2018
Northern Australia	80%	104%	69%
Rest of Australia	64%	65%	64%

Source: ACCC analysis of data obtained from insurers.

Profitability by insurer

Gross loss ratios by insurer were analysed for the eleven year period. Consistent with the aggregate data, generally the eleven year averages at the insurer level are also higher in northern Australia than for the rest of Australia demonstrating poorer profitability. Details of the GLRs per insurer in the relevant date ranges are detailed in Table 6.5 below. While the majority of insurers have larger GLRs than in northern Australia, the insurer level trends also indicate that profitability may have improved for the last five years from 2014 to 2018.

Individual insurer performance has generally improved in northern Australia in the last five years from 2014 to 2018 where the ratios are more in line with the rest of Australia. This is consistent with the timeframe over which the industry implemented significant price increases throughout the northern regions.

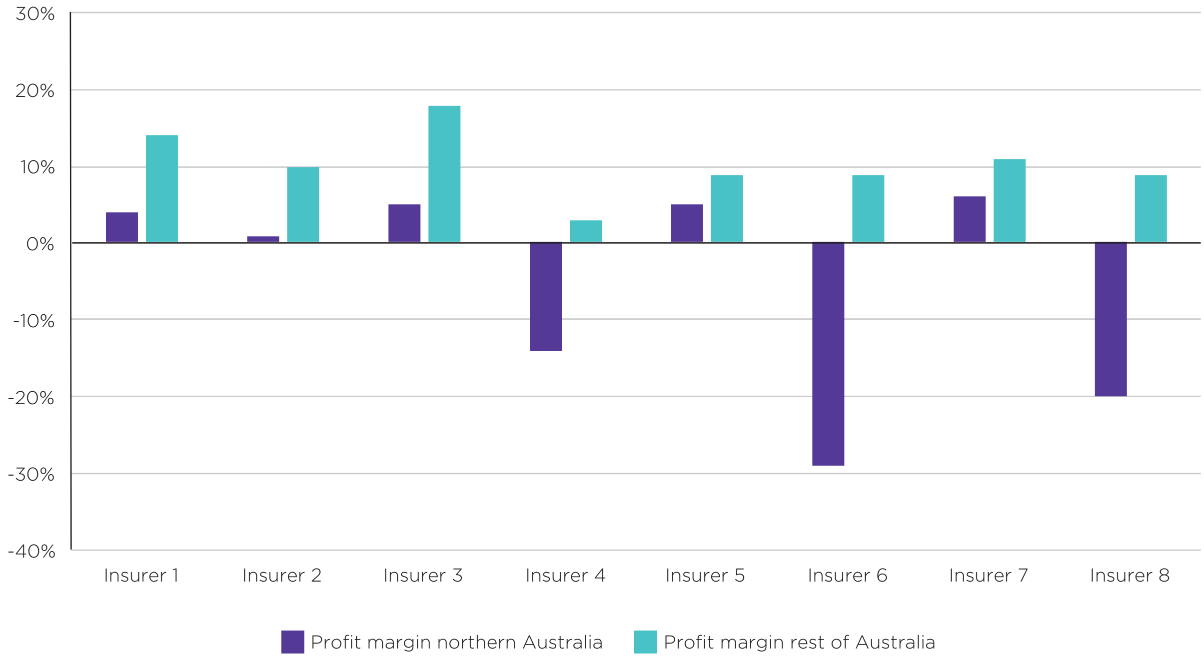
Table 6.5: Gross Loss Ratios for all products

Insurer	Northern Australia			Rest of Australia		
	11 years	2008–2013	2014–2018	11 years	2008–2013	2014–2018
Insurer 1	69%	94%	59%	61%	65%	58%
Insurer 2	49%	48%	50%	53%	51%	53%
Insurer 3	65%	83%	51%	54%	56%	53%
Insurer 4	77%	110%	57%	58%	65%	53%
Insurer 5	79%	122%	50%	56%	69%	44%
Insurer 6	75%	90%	69%	54%	58%	51%
Insurer 7	68%	114%	46%	57%	72%	49%
Insurer 8	92%	115%	78%	71%	80%	65%

Source: ACCC analysis of data obtained from insurers.

Figure 6.9 illustrates insurer profit margins over the eleven years. It compares profit margins in northern Australia and the rest of Australia by insurer. The data indicates that the profit margins have generally been greater in the rest of Australia compared to northern Australia, and for a number of insurers the variation in this margin is substantial.

Figure 6.9: Insurer average profit margins over 11 years for all products



Source: ACCC analysis of data obtained from insurers.

6.5 Profitability in relation to the broader general insurance category

Whole of Australia all general insurance

The statistics recognised in the previous section are for the product lines of home, contents and strata insurance only. Another method of assessing reasonableness of profitability is to compare the performance of these insurance products in northern Australia against the overall general insurance category in Australia. This data includes other general insurance product lines including motor, commercial, travel, and various other classes.

A simple comparator for the performance of the products subject to this inquiry to the whole general insurance category is the COR and NLR. Using the COR and NLR avoids any issues of comparability due to any difference in size between the housing insurance and general insurance sectors.

The following statistics were presented in the KPMG General Insurance Industry Review[90] for 2017. For the five years from 2013 to 2017 the COR for the general insurance industry ranged from 87.9 to 94.4 per cent. The NLR ranged from 61.6 to 68.6 per cent in the same period. The COR for northern Australia averaged 101 per cent for the same period, and the NLR was 71 per cent.

The higher ratios for northern Australia indicate that during the equivalent period, the profitability of home, contents and strata insurance in northern Australia was less than that of the general insurance sector in Australia.

Global comparison general insurance

Publically available global general insurance statistics indicate that CORs in various countries around the world typically fall in the range of around 90 to 105 per cent.

Specifically in the United States the IAIS Global Insurance Market report details that from 1991 to 2016 the average COR in the property and casualty insurance industry was 103.9 per cent. The same market report also indicates that CORs for various other countries including, Germany, Italy, France, Belgium, Japan and more are also typically in the range of 90 to 105 per cent.

This is supported by research from the Swiss Re Institute which in their November 2017 Global insurance review 2017 and outlook 2019 graphed the CORs for Europe from 2010 to 2017. While the range fluctuates year on year, on average it is approximately 95 per cent.

In northern Australia the average eleven year COR for the insurers subject to the inquiry was 121 per cent. For the period 2008 to 2013 the COR was 145 per cent and from 2014 to 2018 it was 108 per cent.

Over the eleven year period the average COR for northern Australia is in excess of the global norms for this metric. Consistent with the movement in profitability in other metrics in this chapter, the COR improving in the last five year period also brings this performance measure more into line with global averages.

6.6 Previous reviews found poor profitability in northern Australia

As noted in chapter 1, there have been several reviews into insurance in northern Australia in recent years. Some of these reviews overlapped the historical periods and sub-regions under review. While the prior reports were unable to obtain complete profit and loss information by product and region, their conclusions are consistent with our findings above.

In the Senate inquiry of 2017 "Australia's general insurance industry: sapping consumers of the will to compare" it was quoted from APRA that in the recent years to 30 September 2016 there has been a deterioration in financial performance of the general insurance industry. APRA was also quoted as not observing excessive profits in the industry at the portfolio level.[91]

The Northern Australian Insurance Premium Taskforce referred to two reports from the Australian Government Actuary in 2014 that higher premiums in north Queensland compared to east coast cities largely reflected higher losses in the region and did not represent excessive profits to insurers. The modelling commissioned by the taskforce also suggests that current premium rates are not out of step with estimates of the magnitude of the risk.[92]

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90 Data from this review was referenced to APRA Quarterly General Insurance Performance Statistics (Direct Insurers only) and KPMG analysis. assets.kpmg.com/content/dam/kpmg/au/pdf/2017/general-insurance-industry-review-2017.pdf.

91 The Senate, *Australia's General Insurance Industry: sapping consumers of the will to compare*, August 2017, p. 23.

92 The Treasury, *Northern Australian Insurance Premiums Taskforce final report*, 2015, p. 19.

In the AGA review of strata insurance in north Queensland it was noted that 'base profitability' has been very poor in those years where significant weather events have occurred (financial years ending 2008 and 2011).[93] In financial year 2007 and 2009 there were no significant natural disaster events but base profitability was still poor at less than 10 per cent of premium.[94] In addition, over the whole period, overall profitability is estimated at about minus 60 per cent of premium. This means that for every $100 of premium earned by the insurers (including the investment return on the invested premium and also allowing for recoveries from reinsurance), around $160 has been spent on reinsurance, claims, commission and operating expenses.[95]

The 2014 AGA review of home and contents insurance in northern Australia reported findings consistent with those above. For home insurance business a GLR of around 60 to 65 per cent might generally be regarded as indicating broadly adequate premium rates. Higher GLRs than this might be regarded as indicating inadequate premium rates.[96] Between 2005–2006 and 2012–2013 the actual GLR during the investigation period averaged more than 140 per cent. This means that insurers paid out more than $1.40 in claims for every $1 of premium that they collected during the period.[97]

6.7 Summary of insurers' profitability in northern Australia

We have found that insurers' profitability in northern Australian markets has generally been poor over the 11 year period considered. However, profitability has improved in the last five years from 2014 to 2018. Performance ratios during this timeframe in northern Australia have begun to trend more towards those experienced in the rest of Australia.

At a regional level the losses were primarily incurred in northern Queensland, however northern Western Australia had the lowest profit margin.

Profitability was again inferior in northern Australia when compared to the rest of Australia by product. Contents insurance is the most profitable product both in terms of gross profit and profit margin. By margin, building insurance is substantially less profitable in northern Australia compared to the rest of Australia.

Insurer level profitability analysis supports the trends that performance has improved in the last five years under review. In addition the ratios are consistent with the aggregate data and show that in northern Australia the profitability metrics are sub-par when compared to the rest of Australia.

The period of improved profitability from 2014 to 2018 coincides with a move to considerably higher premiums, as described in chapter 3. However, this is a relatively short timeframe to consider profitability for products and in areas subject to significant catastrophe risks, and we will continue to monitor profitability throughout this inquiry.

93 Base profitability is defined by the Australian Government Actuary as gross premium plus investment revenue minus gross claims expense, minus commissions and expenses. All divided by gross premium. The metric excludes reinsurance expenses and recoveries.

94 Australian Government Actuary, *Report on investigation into strata title insurance price rises in North Queensland*, 2012, p. 6.

95 Ibid, p. 11.

96 Australian Government Actuary, *Report on home and contents insurance prices in North Queensland*, 2014, p. 12.

97 Ibid, p. 13.

7. Competition in northern Australian insurance markets

Key points

- We have a number of concerns around the effectiveness of competition in some parts of northern Australian insurance markets.
- Northern Australia makes up a relatively small proportion of policies within Australia and forms a small part of an insurer's overall portfolio. However, many areas are considered high risk due to higher probabilities of cyclone and flood events.
- For these high risk areas, it appears insurers are not actively trying to win market share as a relatively high market share in a high risk area can result in significant claims costs in the event of a catastrophe. Instead, insurers are implementing strategies to manage their exposure to the risk of concentration in these areas by increasing premiums or not writing new business.
- Insurers strive to improve the accuracy of their risk pricing models. However, the relative unpredictability of catastrophic events means the level of risk for a particular policy in high risk areas is not as certain as for other types of risks. Insurers routinely monitor prices offered by other insurers, and where they are the lowest priced offer they may fear that they have mispriced the risk. They then respond by raising their price.
- As insurers adjust premiums in high risk areas based on their current mix of policies and in order to manage their concentration risk, this can result in vast differences in quoted premiums between insurers. However, it is not easy for consumers to find out about cheaper alternatives as the market has several features which make it difficult for consumers to compare offers.
- Insurance markets in northern Australia are concentrated. It is particularly concentrated in regional markets within northern Australia, some of which can be dominated by a single insurer.
- Barriers to entry into northern Australian insurance markets are likely to be significant for insurers not already established in other parts of the country. However, barriers to expansion or re-entry into northern Australian markets for established Australian insurers appear to be much lower. Despite some recent entry there are still fewer participants in northern Australia than in the rest of Australia. The number of insurers supplying home, contents and strata insurance in northern Australia has reduced from eleven to eight over the last 10 years.
- Comparison shopping is also difficult in this market. Coverage and exclusions are not defined in a consistent way across insurers. Eight insurers in northern Australia sell home, contents and strata insurance via approximately 29 different brands and 113 intermediaries, creating the illusion of more competition than actually exists and making comparisons more difficult.
- This has resulted in customer inertia and a reliance on known or familiar brands. Yet customer inertia appears to be resulting in those consumers paying higher premiums at renewal and continuing to pay higher premiums compared to those who shop around for the best deal and switch suppliers.

This chapter looks first at how insurers generally compete in insurance markets, before making an assessment of competition in northern Australian markets.

Effective competition between insurers is crucial for maintaining downward pressure on the costs of providing insurance, and for passing through the benefits of cost reductions to consumers.

When assessing the effectiveness of competition within markets, the ACCC will not only consider current conditions and behaviour, but will also consider features likely to affect competitive supply of services in the future. To assist in its assessment, the ACCC has regard to a number of factors including barriers to entry, concentration levels, price and non-price rivalry and consumer understanding and switching.

7.1 Previous findings and stakeholder views on competition

As highlighted in chapter 1, multiple inquires have looked at insurance in northern Australia and Australia more broadly. Several have expressed concern at the current state of competition within these markets.

The Productivity Commission's Final Inquiry Report into Competition in the Financial System 2018 notes that Australia's general insurance market is highly concentrated. It found for national home, contents and strata insurance, the largest four firms hold market shares in excess of 70 per cent. This concentration has increased slightly in recent years, mostly as a result of licence consolidation activity.[98] Because many insurers supply their products under multiple brands, the Productivity Commission noted consumers may see more an illusion of robust competition than a reality.[99]

The Senate Economics References Committee's 2017 report into Australia's general insurance industry (the Senate Inquiry) also noted stakeholder concerns that Australia's general insurance industry gives the 'illusion of competition', rather than genuine competition. The report noted concerns that competition in the general insurance market 'is not fully effective', and that there is a clear weakness on the demand side of competition in the industry. This manifests in low rates of consumer switching between insurers (consumer inertia), and the wide disparity that may be found between insurers in their quotations for identical properties and risks.[100]

Industry submissions consider competition is working in northern Australia

In its submission to the inquiry, the Insurance Council of Australia (ICA) acknowledges that consumers in northern Australia are facing increased premium prices, at a time the industry is facing reduced profitability. However, the ICA says contrary to some perceptions, no significant insurers have left markets in northern Australia and none are generating large profits in those markets. Rather, insurers are operating with modified underwriting requirements, avoiding risks considered beyond their capacity to service and operating in a difficult investment environment with 'satisfactory' financial performance. The ICA submits that, despite these market conditions, consumers in northern Australia do have a strong choice of insurance providers, the market is competitive and premiums reflect risk.[101]

Other industry submissions also consider that insurance markets in northern Australia remain competitive.

IAG asserts that robust competition still exists in northern Australia, demonstrated by the number of insurers and products and services offered to consumers.[102] While Suncorp considers it has not observed any signs of market failure, believing that the levels of shopping around and switching insurers show a healthy and competitive market.[103]

There is a general acknowledgement, however, among industry submissions that premiums have risen in northern Australia over the past decade.[104]

98 Licence consolidation refers to a corporate group transferring its separate insurance licences to a single parent entity. It is predominantly related to the rationalisation of insurance licenses resulting from past acquisitions. The reduction in licences helps manage regulatory requirements more efficiently, align legal structures and simplify financial and administrative processes.

99 Productivity Commission, Chapter 14: General insurance providers and products, *Competition in the Australian Financial System—Inquiry Report,* June 2018.

100 Senate Economic Reference Committee, *Australia's general insurance industry: sapping consumers of the will to compare*, August 2017.

101 ICA submission, pp. 26, 37.

102 IAG submission, p. 1.

103 Suncorp submission, p. 24.

104 See IAG, Suncorp and RACQ submissions.

However, residents in northern Australia disagree

In submissions to the inquiry and at the public forums, many residents expressed views about a lack of genuine choice for them in northern Australia. People discussed their efforts to negotiate with insurers, switch between insurers and use brokers to find cheaper insurance. However, they generally found that these activities had little impact on their premiums. Some individuals reported success using brokers to obtain insurance in an otherwise difficult-to-insure area, however, not everyone had the same success.

Increasing premium prices leaves many individuals with no option but to adjust their coverage levels and increase their excess to improve affordability. For many people who attended our public forums, affordability issues resulted in them increasing their excess, reducing their sum insured or coverage even if this meant the coverage was inadequate for their needs, or forgoing insurance altogether.[105]

Consumers' experience with buying home and contents insurance is discussed further in chapter 9.

7.2 How insurers compete in insurance markets

Insurers predominantly compete for business on price, policy coverage, and quality of service.

Price terms include the upfront premium (which is set with regard to the sum insured and the level of excess the insured is required to pay), and whether any discounts are available to the consumer, say for bundling other forms of insurance or for being a new customer.

Insurers also compete on non-price terms. This includes different levels of coverage for prescribed events, and whether their policy includes features such as accidental damage, personal valuables cover or total replacement in cases of catastrophe.

For many people, another important consideration is that an insurer will quickly and fully pay any claims. When a person purchases insurance, they are purchasing a promise that when an event occurs that requires rebuild, repair or replacement, their insurer will act quickly and decisively to protect what for many people is their most valuable asset. As a result, insurers can also leverage their brand reputation and value to gain customers and extract a higher premium.

Price rivalry between insurers

One of the primary factors insurers compete for customers on is price. Price terms include the upfront premium, the sum insured and the level of excess payable in the event of a claim, as well as any discounts available to the consumer.

As detailed in chapter 5, there are a number of 'risk factors' which increase the chance that a claim will be made for a particular property. For home and contents insurance, these are the property location (e.g. in a flood-prone area, an area subject to storm surges or in a cyclone-prone area), the age of the property (with more modern buildings constructed to more stringent building standards able to withstand extreme weather events), and the construction materials used (such as fibro compared to brick).

The competitive advantage of accurate pricing

Insurers' ability to set premiums that accurately reflect the risk of providing insurance is important to their ability to compete in a market. First, it helps an insurer set prices in a way that will ensure that it remains profitable. Second, it is important to sending the right price signals to consumers, and helps the insurer to maintain the right 'mix' of risks. If an insurer sets premiums too high relative to the risk being insured, it is likely to lose business to more accurately priced competitors. Conversely, if an insurer sets its premiums too low, it may face 'anti-selection' where its share of high risk customers increases, which can lead to high claims and reinsurance costs (this is discussed in further detail in chapter 5).

105 See ACCC Public Forum summaries 2017 www.accc.gov.au/focus-areas/inquiries/northern-australia-insurance-inquiry/public-forums.

The importance of accurately pricing insurance means that the insurers invest significant resources in developing their pricing models and these are valuable intellectual property.

Insurers will also put in place strategies to ensure that they are not over exposed in high risk areas (for example cyclone, flood and bushfire zones) otherwise their reinsurance costs will be higher causing premiums to rise and making them less competitive compared to other insurers. These strategies often take the form of 'premium adjustments', seeking to discourage or price out certain customer segments or otherwise reduce the insurer's exposure in particular areas. These adjustments are considered in detail in chapter 5.

The difference in pricing approaches and sophistication also creates a level of differentiation in the market, as one insurer may rate an individual risk differently to a competitor resulting in different premiums for a consumer. This can create opportunities for consumers to save a significant amount of money by switching to an alternative brand. However as discussed below, there can be significant impediments to switching, reflected in high retention rates in northern Australia.

Excess levels

The excess is the amount payable by a consumer in the event of a claim, and represents the risk retained by the customer. The higher the excess, the higher the amount of risk retained by the insured and the lower the premium will be.

As set out in chapter 3, average excess levels are considerably higher across northern Australia (other than the Northern Territory) than they are for the rest of Australia and, across the country, average excess levels have grown significantly since 2007–08.

Insurers, their brands and their intermediaries may compete on price by varying their default excess levels, or otherwise encouraging customers to increase their excess amount. At least two insurers have increased their default excess in recent years to the industry average of $500. One of these noted this was done so as to not be competitively disadvantaged as recent research had indicated the up-front premium was the primary driver of taking up a policy, and most consumers accept the default excess level.

Chapter 3 also notes that consumers in northern Australia appear more likely to increase their excess levels from default amounts, when compared to southern capital cities.

Competing through offering discounts

Insurers may also compete on price through the use of discounts. Examples include new customer discounts, discounts for buying online, bundling or multi-policy discounts for consumers who hold multiple products with the same insurer and no claim bonuses.

The most common form of discount offered by insurers and undertaken by consumers in both northern Australia and nationally is the 'no claim bonus', a discount for not having made a claim over a number of years.[106] A no claim bonus will also serve to discourage small claims that are just over the excess level of a product.

The next main form of discounting is bundling, where an insurer will offer a discount for a person taking out multiple forms of insurance with the one company (for instance, home, contents and motor insurance). While some insurers also offer discounts to a customer that purchases their insurance online, as selling insurance online reduces overhead costs for insurers, or for being a new customer.

Discounts may also be offered for being a longstanding customer ('loyalty discounts'). While a 'no claim bonus' can sometimes be transferred to a different insurer (or otherwise recognised through their pricing methodology), a 'loyalty discount' cannot. So while these discounts can have a direct impact on premiums, they may also serve to discourage consumers from switching brands. Of the eight insurers we obtained data from, four offer a 'loyalty discount'. However, this is not uniformly offered across their brands.

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106 Source: ACCC, based on information provided by insurers.

‘Loyalty discount’ uptake is much lower than discounts for no claims or for bundling, with approximately 12 per cent of discounts currently applied being for staying with an insurer for multiple years. Whereas approximately 47 per cent of current discounts are for making no claims in recent years and 27 per cent are for holding another relevant product with the same insurer. These trends are similar for both northern Australia and Australia as a whole.

The scale and type of discounts offered by insurers are discussed in more detail in chapter 5.

Non-price rivalry

Alongside price competition, insurers also compete on non-price terms. This includes different levels of coverage for prescribed events, such as whether their policy includes features such as accidental damage, personal valuables cover or total replacement in cases of catastrophe and service, including claims handling.

At a basic level of cover, insurers will cover the insured for a prescribed range of events. Insurers may compete on the types of events included in a policy as standard. For example, NRMA offers storm surge as part of its standard home and contents insurance product whereas Youi does not.

Insurers may also compete on introducing product innovations that differentiate themselves from other insurers. After the 2002 ACT bushfires, two Insurers adopted extended replacement policies that provided an additional 25 per cent or 30 per cent above the sum insured.[107] This now is an optional extra offered by most insurers.

However, competition between insurers in terms of product features can make it difficult for consumers to compare between products and can add to their searching costs. This, coupled with a reluctance to move away from a familiar product, can act against more active consumer engagement in insurance markets.

Finally, insurers compete on service and claims handling ability, which will largely be dependent upon reputation and previous customers’ experience. These are discussed in more detail in chapter 11.

7.3 Barriers to entry, expansion and/or exit

A potentially potent source of competition is new entry or the threat of new entry. While barriers to entry in insurance appear high overall, many of these barriers are not specific to expansion into northern Australia. We have seen some entry into northern Australia in recent years.

For the insurance market, barriers to entry include prudential capital and reporting requirements (set and administered by APRA), the costs of obtaining or developing the data required to accurately price risk in the relevant areas, the cost of reinsurance, the need to establish repair/replacement networks, developing sales channels and claims processes, and marketing costs to establish brand awareness.

We discuss some barriers to entry here and flag some for further exploration.

Barriers to entry are high

Barriers to entry into northern Australian insurance markets are significant for insurers new to the Australian market. For a new entrant (with no existing Australian authorised insurance businesses), we have estimated these costs as being in the range of $16–40 million based on cost estimates for items including but not limited to the cost of prudential and surplus capital, salaries, information technology establishment, marketing, product development, legal and regulatory requirements, among other things. The process of estimating establishment costs is very subjective, and can vary greatly given the ambitions for growth for any new entrant. Accordingly the range is considered to be a tentative estimate. However, it is clear that the sector is capital intensive and the cost for new entrants is substantial.

107 ASIC report 89, *Making home insurance better*, January 2007, p. 9.

An alternative way to understand entry costs is to view the historical data of new entrants in recent years. Youi entered the Australian market in Queensland (with motor insurance), but quickly expanded into home insurance as well. Youi's first financial statement since its inception showed shareholder equity of approximately $21 million at 30 June 2008.[108] According to APRA statistics, Youi experienced losses every year from 2008 to 2011 ($89M in total) and would have required capital injections of at least this magnitude to support the required capital, until they made a profit in 2012.

Another example is provided by iSelect. iSelect was informed by a major UK insurer that the initial capital required for a new entrant to the Australian market would be upwards of $25 million AUD, and the time commitment would be greater than 12 months, which made the proposition marginal at best on a risk-weighted basis.[109]

APRA sets prudential requirements for insurers

General insurers are required to be authorised under the *Insurance Act 1973*.[110] Once licenced by APRA, they are subject to prudential supervision. The process involved in obtaining this authorisation is extensive and includes proving to APRA that the insurer would comply and continue to comply with prudential requirements. An example, in addition to the core capital requirements, is that APRA requires that the substantial shareholders (i.e. owners) of the applicant seeking an authority to carry on insurance business in Australia be well-established and financially sound entities or individuals of standing and substance.[111]

Capital requirements imposed by APRA set a floor for the amount of capital an insurer must hold. Above a basic threshold, which is typically $5 million, this prescribed capital is dependent on their level of risk. The intent of requirements is to make sure insurers are able to meet the cost of claims made by policyholders.

The standards are considered to be a safeguard which is in place to minimise the likelihood of insurers holding insufficient capital. Without regulatory intervention insurers could operate with less capital, however, at a substantially greater risk of insolvency in times of catastrophe.

APRA's Life and General Insurance Capital Standards (LAGIC) are risk based. As a result insurance policies written in high risk locations result in a higher mandated prescribed capital amount.[112] Components such as the premium liability Insurance Risk Charge and the Insurance Concentration Risk Charge may be impacted the most.[113]

For northern Australia, the impact of the prescribed capital amount is heavily dependent on the technical risk of the underlying policies, the concentration of those risks in geographic locations and related reinsurance coverage.

There are no specific regulatory capital consequences of selling insurance in northern Australia which are different to the rest of Australia, as each risk is assessed based on its own risk profile. Consequently if more capital is required to underwrite northern Australian policies it is because the underlying risk is more evident and therefore greater security is needed to protect policyholders.

Prudential capital requirements set by APRA serve an important role in maintaining policyholder confidence that claims will be paid. Insurers also aim to maintain a target surplus of capital that is significantly more than is required by APRA. For the insurers examined in the inquiry so far, their average capital held is typically almost twice the prescribed capital requirement. Insurers aim to

108 APRA, *Annual General Insurance Institution–level Statistics December 2017—Database*, last updated May 2018.

109 iSelect submission to the Senate Economic Reference Committee, *Australia's general insurance industry: sapping consumers of the will to compare*, 10 February 2017, p. 4.

110 *Insurance Act 1973* (Cth), ss. 9, 10, 11, 12(1).

111 APRA, *Guidelines on Authorisation of General Insurers*, December 2007, p. 6.

112 APRA Prudential Standards GPS 110–118.

113 The Insurance Concentration Risk Charge is the minimum amount of capital required to be held against insurance concentration risks. The Insurance Concentration Risk Charge relates to the risk of an adverse movement in the general insurer's or Level 2 insurance group's capital base due to a single large loss or series of losses. APRA Prudential Standard GPS 116.

maintain a healthy capital buffer over the prescribed amount to ensure they do not trigger very significant intervention from APRA.

Barriers to expansion are low

However, for those insurers already operating elsewhere in Australia, many of these barriers would be significantly lower.

Existing insurers will already have regulatory approval, skilled workforces, established statutory reporting frameworks, sales channels, underwriting skills and claims processes. They will also have some degree of brand awareness. The main barriers insurers would still face are in the form of costs of reinsurance, risk models and data sets relevant to northern Australia and the need to ensure their repair/replacement networks are able to service these areas. These remaining barriers are considered below.

The cost of reinsurance will impact an insurer's ability to enter the region, being a critical element for operating in northern Australia. Reinsurance is particularly important in northern Australia, where claims costs are more variable and subject to major spikes resulting from catastrophe events, as described in chapter 4. However, existing insurers already have reinsurance programs in place which could be extended.

The costs of obtaining or developing the data required to accurately price risk in the relevant areas will also represent a barrier to expansion into northern Australia. While industry vendor models are more likely to be used in modelling catastrophe perils, some insurers that are established in the region have developed their own risk models using a mixture of information from external sources and their own data and modelling. As such, new entrants will be at a competitive disadvantage (at least initially) against established insurers. As well as impacting on the accuracy of pricing decisions for their own customers, this may also affect an insurer's ability to negotiate reinsurance.

As described in chapter 11, insurers each have a designated panel of builders and repairers that will manage the repair process on their behalf. While an insurer established in other parts of Australia would already have such networks in place, there may be a considerable cost in extending these to northern Australia, particularly the more remote regions.

In order to ensure a smooth claims experience for their customers, new entrants would need to invest time and resources into setting up new, or expanding existing agreements with builders/repairers to successfully manage claims processes and provide cost-effective outcomes.

Despite the barriers to expansion appearing to be considerably lower than the barriers to entry in northern Australia, many insurers, including insurers of significant scale, have either left or continue to stay out of northern Australian insurance markets.

As noted later, there are fewer insurers supplying insurance in northern Australia markets than in the rest of Australia. Notable insurers absent from northern Australia include large established insurers such as RAC Insurance Pty Limited (RAC)[114] in Western Australia and AIG Australia Limited (AIG), as well as new entrants to the Australian market Hollard Insurance Company Pty Ltd (trading as Real) and Auto & General Insurance Company Limited (trading as Budget Direct). Why these insurers generally do not write new business in northern Australian markets is an area we consider warrants closer consideration as the inquiry progresses.

114 The Royal Automobile Club of Western Australia is a motoring club and mutual organisation.

Focus area 4: Identify and investigate barriers to expansion (or re-entry)

We will engage with Australian insurers not currently active in northern Australia to identify and investigate barriers to their expansion (or re-entry) into northern Australian markets.

We consider that for those insurers already operating elsewhere in Australia, barriers to expanding into northern Australia are significantly lower than the barriers for a new entrant to the Australian insurance market. However, some established insurers generally do not write new business in northern Australia.

We will continue to explore, in consultation with insurers, the regulatory and other barriers to expansion into northern Australia. We will also engage on this issue with insurers active in only some regions of northern Australia.

Unauthorised foreign insurers are a last resort

In certain circumstances, unlicensed foreign insurers are permitted to underwrite risks in Australia. Unauthorised Foreign Insurers (UFIs) are foreign domiciled insurers and are not authorised by APRA to carry on insurance business in Australia except under limited exemption arrangements.

The current circumstances in which an UFI may write business in Australia include:

- purchases by 'high value' insureds (those with $200 million revenue or gross assets or with 500 staff)
- insurance for atypical risks (including risks arising from war, nuclear or biological hazards, space debris, and certain aircraft and marine vessels risk), or
- where a broker has certified that a risk cannot reasonably be placed with an Australian insurer, including on the basis that the price offered by Australian insurers is substantially less favourable.[115]

APRA statistics indicate that there are low volumes of UFI activity particularly after excluding fire and industrial special risk placements.[116] For property insurance in northern Australia the challenge under the current guidelines is that any UFI would have limited incentive to assess and insure a risk that was effectively rejected by the existing market participants. If they were to do so it would be for low volume and high risk properties only, and these factors in combination are less likely to be attractive to a UFI.

While UFIs may legally operate in northern Australia through exemptions under which a broker can place business off-shore, to a considerable extent, these insurers do not participate. The latest national APRA figures show that in the six months to 30 June 2017, of the intermediaries that placed business directly with underwriters in the period, only nine per cent placed business with UFIs.[117] Some consider the challenges and costs involved in operating in northern Australia effectively restrict sustainable participation to those with the capital and underwriting experience to do so.[118]

Careful consideration and caution is needed before any changes are made to regulations for UFI participation in Australian markets. The purpose of significant capital and risk management requirements is to ensure insurers have sufficient capital to pay claims in the case of a significant adverse claims experience. Without these requirements, a UFI may take unreasonable risks with capital requirements and may face a circumstance where it is unable to pay its liabilities to Australian policyholders, leaving consumers financially devastated.

Barriers to exit are low

For insurers currently supplying home, contents and strata insurance in northern Australia, barriers to exiting markets are low. Home, contents and strata insurance is considered a 'short tail' risk, where the

115 Explanatory Statement Corporations Amendment Regulations 2009 (No. 11) (Select Legislative Instrument 2009 No. 387).

116 APRA Intermediated General Insurance Statistics June 2018.

117 APRA Intermediated General Insurance Statistics, 5 September 2018.

118 ICA submission, p. 32.

costs of claims are usually incurred during the term of the policy, or shortly after. As a result, an insurer usually does not hold any residual liabilities if it chooses to exit those markets.

There can be a reputational risk to insurers that choose to exit northern Australian markets, particularly with an insurer's relationship with insurance brokers. For example, when Zurich exited northern Australian insurance markets in 2016, it considered the impact its exit might have on its relationships with its brokers and ensured it communicated to them reasons for its decision to exit. Exiting markets may also diminish brand value with consumers in those markets. An insurer may seek to avoid this by continuing to insure existing customers but not new business. As discussed in chapter 5, premium adjustments may be applied in order to 'shed' customers and exit the area over a longer period.

7.4 Current state of competition in northern Australia

We consider that there are a number of factors that raise concerns about the way competition is working in some parts of northern Australian insurance markets.

First, the insurance market in northern Australia is concentrated. This is partly the result of insurers obtaining the customer bases of the former state and territory owned insurers in Queensland and Northern Territory. Due to north Queensland accounting for the large majority of northern Australia in terms of gross written premium and number of policies, Suncorp is the dominant market leader and retains the largest market share in north Queensland and in northern Australia overall. The TIO brand remains dominant in the Northern Territory.

Second, there has been a softening of competitive pressure for segments of markets within northern Australia. Recent catastrophes, particularly those in the 2010–11 financial year, have highlighted the impact on insurers of having a large number of customers in any given high risk geographic location which, if struck by catastrophe, can result in significant claims costs.[119] Large exposures in catastrophe-prone areas also raises costs for insurers in the form of increased prudential capital requirements and reinsurance costs. As a result, it appears that in some parts of northern Australia insurers are not actively trying to win market share. Instead, many insurers make concerted efforts to reduce their exposure to parts of those markets considered high risk. They do this by exiting segments of the market or by raising prices.

The unpredictability of catastrophic events means the level of risk for a particular policy is not as certain as for other types of risk and so insurers have less confidence in their pricing models. As a result, insurers routinely monitor prices offered by other insurers for particular risks with an eye to avoiding being the lowest priced insurer. Where they are the lowest priced offer they may fear that they have mispriced the risk. They then respond by raising their price. Even if an insurer believes it is in fact pricing accurately, they may still increase prices in high risk areas to reduce the chance of acquiring a concentration of high risk consumers.

Third, the market has several features which make it difficult for consumers to compare offers. There are a large number of insurance products, with differences in coverage, exclusions and inclusions, excess level, type and degree of discount, and price. Price can also vary where the product is offered in a bundle.

Components of coverage and exclusions are not defined in a consistent way across insurers, making comparisons difficult. Insurers offer products across a large number of brands and intermediaries, increasing the number of possible products for comparison even though the number of general insurers is fewer. The use of third parties to assist consumers is complicated—insurance brokers have potential conflicts of interest as they are commonly remunerated by the insurer, and comparison sites are not sufficiently useful due to the sites tending to have incomplete coverage of insurers and due to the above mentioned differences in definitions across insurers.

The difficulties consumers face in comparing offers leads to a degree of customer inertia and a reliance on known or familiar brands. In a market where comparison shopping is difficult, consumers may tend to stick with brands they know or already use.

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119 In 2011, extreme weather events were estimated to have cost the insurance industry approximately $5.2 billion. Deloitte Access Economics, *Building our nation's resilience to natural disasters*, June 2013, p. 20.

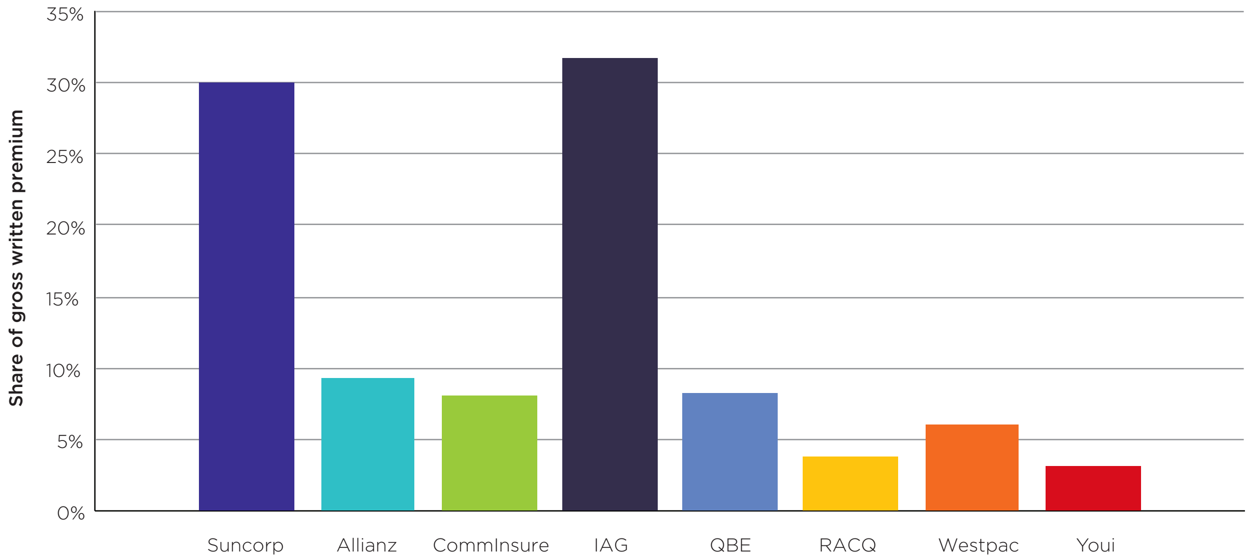
Concentration and market share

The first indicator that raises concerns around the level of competition in northern Australia is the level of concentration in northern Australian insurance markets. Both the home and contents insurance markets, and the strata markets are largely dominated by a small number of insurers. Further, there are also fewer insurers operating in northern Australia.

Home and contents insurance markets

In the national home and contents insurance markets, the clear leaders are IAG and Suncorp with approximately 32 and 30 per cent market share respectively, while QBE, Allianz and Comminsure are the next largest insurers with market shares of approximately eight to nine per cent.

Figure 7.1: Insurers' share of total gross written premium for home and contents insurance products nationally, 2017–18

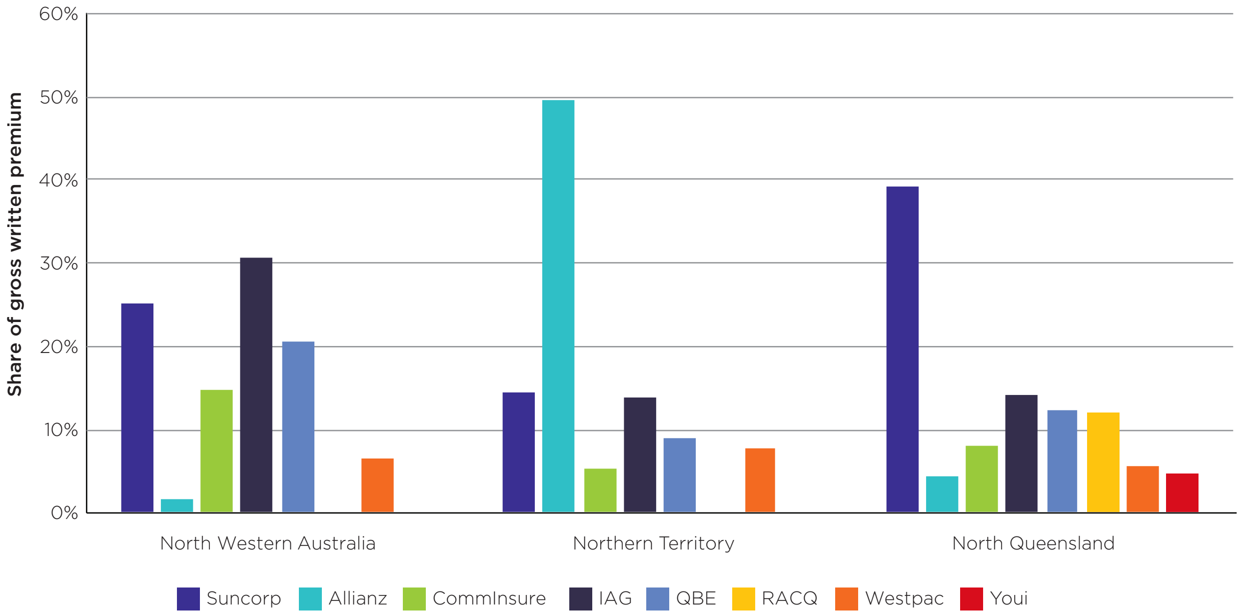


Source: ACCC analysis of data obtained from insurers.

However, shares appear to be to be less spread in parts of northern Australia. As noted in the Update Report, the north Queensland and the Northern Territory markets each have one insurer that holds a significant proportion of the total premium for the region with Suncorp holding almost 40 per cent share of the north Queensland market and the Allianz owned TIO brand holding almost 50 per cent share of the Northern Territory market.[120]

120 These figures are slightly updated from the Update Report as we obtained updated information provided by the Insurers and includes the addition of Defence Service Homes Insurance (DSHI).

Figure 7.2: Insurers' share of total gross written premium for home and contents insurance products in northern Australia regions, 2017–18



Source: ACCC analysis of data obtained from insurers.

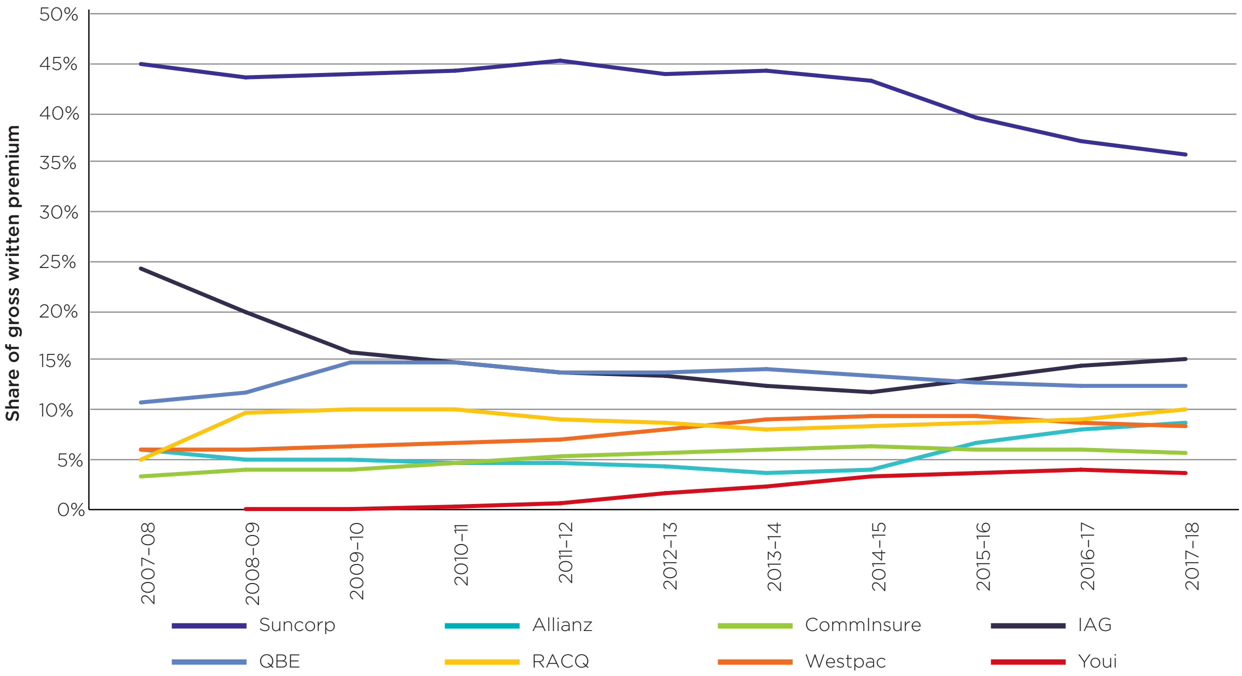
These trends in north Queensland and the Northern Territory appear to be, at least in part, a result of historic acquisitions of state and territory government insurance. Suncorp, formed from the former State Government Insurance Office of Queensland has the majority share of premium for home and contents insurance products in north Queensland. While the TIO brand, previously owned by the Northern Territory government, is the clear leader in the Northern Territory.

We note that the position in north Western Australia is slightly different as no one insurer has a significant share of the market. RAC, one of the leading insurers in Western Australia, does not provide services in the northern part of the state. While the market share of the leading insurer in north Western Australia, IAG, has reduced in the last decade. This appears to be a result of previous IAG strategies to reduce its exposure in high risk areas. For example, in 2008, the focus for IAG's leading Western Australian brand (SGIO) for central and north Western Australia was to price so as to reduce its exposure to cyclone risk. In 2014, SGIO's home strategy was to hold position at its current market share levels by targeting select risk segments and reducing its exposure to high flood and cyclone regions.

As shown in figure 7.3, Suncorp is the leading insurer by market share of total gross written premium for home and contents insurance and has been for the last 10 years. However, the two leading insurers in northern Australia, Suncorp and IAG, have seen a significant reduction in their share over the same period.[121]

121 Allianz's increase in market share since 2014–15 is driven by its acquisition of the TIO.

Figure 7.3: Insurers' share of total gross written premium for home and contents insurance in northern Australia, 2007–08 to 2017–18



Source: ACCC analysis of data obtained from insurers.

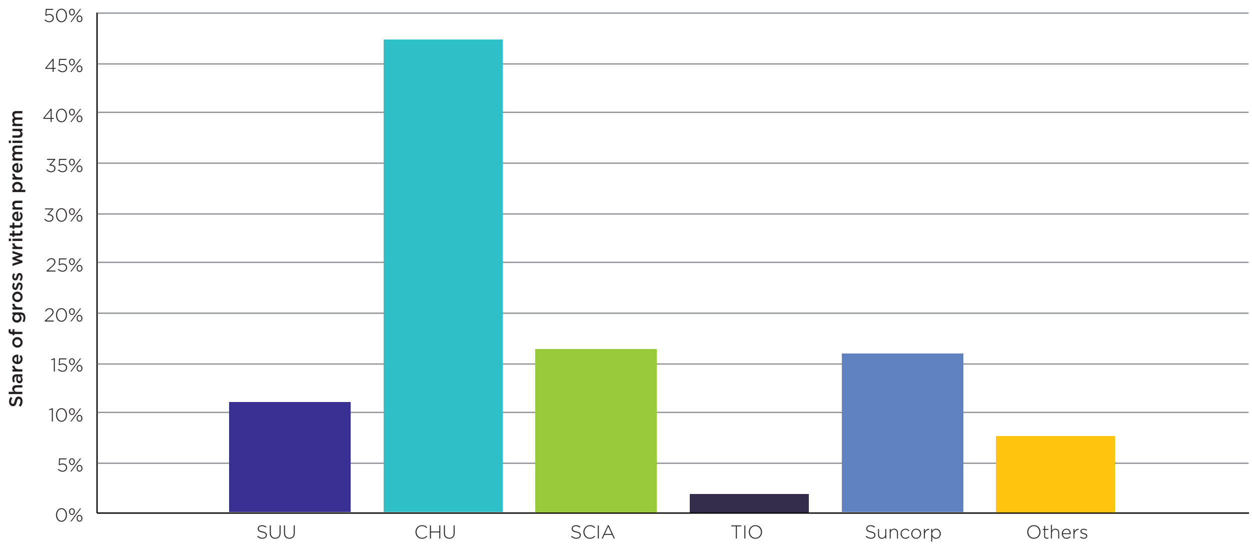
Strata insurance markets

Similarly, strata insurance markets also appear to be dominated by a smaller number of insurers.

As noted earlier, intermediated strata insurance brands such as CHU (underwritten by QBE), SUU (IAG), SCIA (Allianz), and Suncorp via its Longitude and Resilium brands lead the national residential strata insurance market.[122] Nationally, CHU has by far the largest share of total gross written premium for strata insurance with approximately 47 per cent, this is illustrated below in figure 7.4.

122 Figures are based on information provided by the insurers subject to the inquiry. This does not include two additional insurers, who we understand collectively have approximately 10 per cent of the market share.

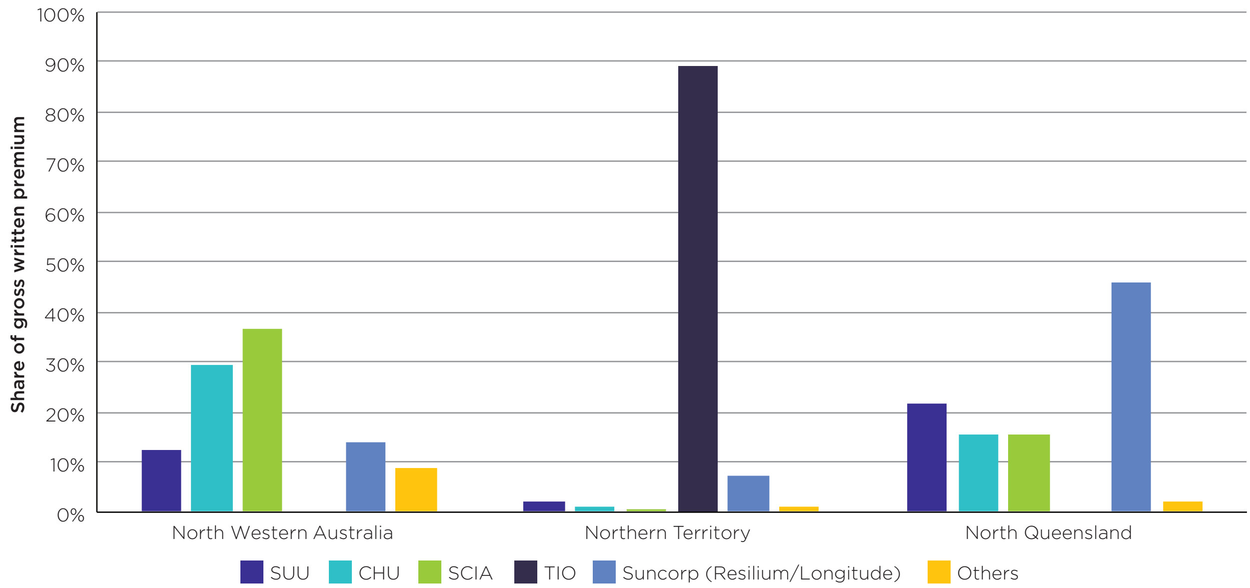
Figure 7.4: Retail brands' share of total gross written premium for strata insurance nationally, 2017–18



Source: ACCC analysis of data obtained from insurers.

However, like residential home and contents insurance, the strata insurance market shares differ from the national trends, as illustrated in figure 7.5 below.

Figure 7.5: Retail brands' share of total gross written premium for strata insurance products in northern Australia regions, 2017–18



Source: ACCC analysis of data obtained from insurers.

Again, the TIO is by far the largest supplier of strata insurance in the Northern Territory, with a share of close to 90 per cent of the total retail premium for residential strata, likely due to its historical position as the government insurer. In Queensland, Suncorp is the largest supplier of strata insurance thanks to a combination of its Longitude (27 per cent), Resilium (10 per cent) and Suncorp (8 per cent) brands. While in north Western Australia the current leading brand is SCIA, however, this fluctuates regularly due to the small size of the residential strata market in north Western Australia.

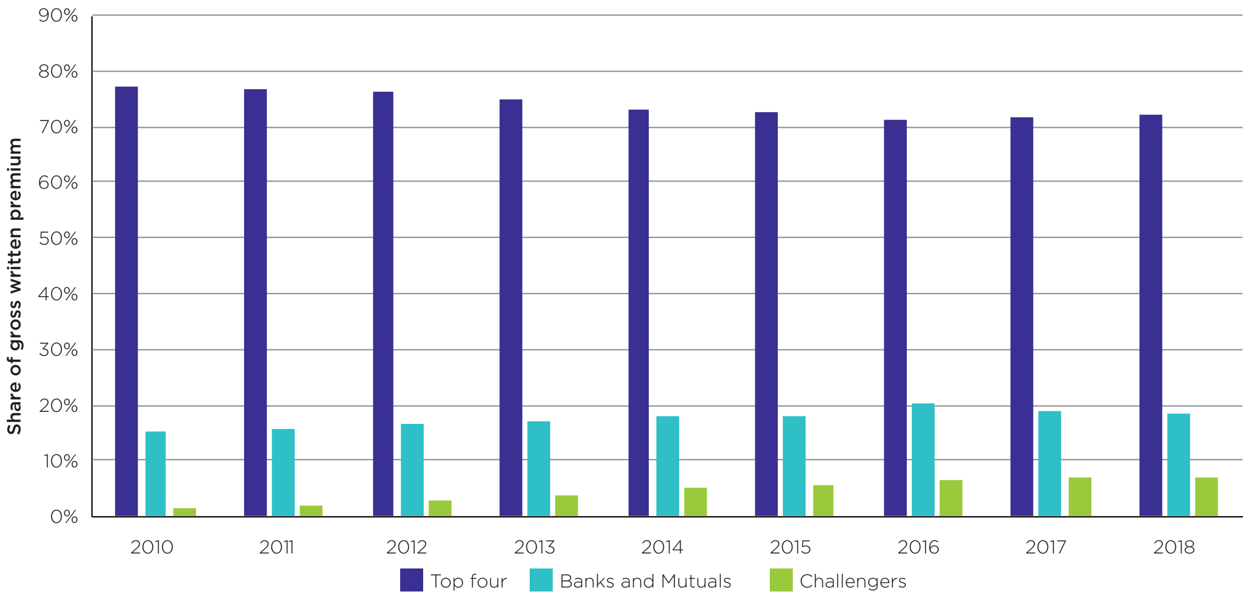
Overall, for both strata and home and contents insurance it does appear that the markets are led by the insurers who have acquired former state government or state based motoring association insurers.

Fewer insurers participate in the northern Australian markets

There are also fewer insurers supplying insurance in northern Australian insurance markets than in the rest of Australia. For example, Hollard, Auto & General, Chubb Insurance Australia Ltd, AIG and RAC generally do not write new business in northern Australia, while Zurich exited northern Australian strata insurance markets in 2016. These insurers account for approximately nine per cent of home, contents and strata insurance gross written premium nationally.[123] This means that consumers in northern Australia are not benefiting from the competitive pressure that these insurers exert in the rest of Australia. Understanding why these insurers generally do not supply insurance in northern Australia is a focus for the inquiry in 2019.

For example, Hollard and Auto & General brands, have frequently been referred to as 'challenger brands', as they seek to gain market share by aggressively competing on price. Many customers that switch to challenger brands are price sensitive consumers seeking low priced insurance products that typically offer less coverage. Since 2010, challenger brands (which include Youi) have increased their market share of home, contents and strata insurance significantly, increasing from 1.6 per cent to approximately seven per cent in eight years while the share of the top four insurers has decreased from approximately 77 per cent to 72 per cent in the same period. This is illustrated below in figure 7.6.

Figure 7.6: Different groups of insurers' share of total gross written premium for home, contents and strata insurance nationally, 2010–2018



Source: ACCC analysis of data provided by APRA.

Some northern Australian insurance regional markets have much fewer effective participants, as not all insurers cover all regional markets and some insurers can seek to reduce exposure in regional markets either through refusing policies of a certain risk profile or by increasing premiums. For example, in 2011 one insurer committed to reducing property exposures in cyclone-prone areas of northern Australia due to the high cost of weather events in those areas and the increasing prices for catastrophe reinsurance for norther Australian property risks. It did so by not writing any new policies in designated areas.

However, insurance markets are dynamic, and insurers constantly assess their exposure to risk within their portfolios. While for a period insurers may reduce exposure by refusing to write new business or by increasing premiums, this may change year to year depending on changes to their mix of risks within their portfolios and changes to their risk appetite. For residents of northern Australia, this results in fluctuating numbers of active participants in those markets.

For strata insurance, we have also seen insurers decide to exit the northern Australian market. Prior to 2011, Zurich Australian Insurance Limited (Zurich) and ACE Limited (now known as Chubb) also

123 Source: APRA, Senate Inquiry 2017.

provided strata insurance in Queensland. However since this time, Zurich has withdrawn completely from providing strata insurance while Chubb has only limited residential strata business in northern Australia predominantly focussing on commercial lines and non-strata high end residential properties with large individual sums insured in other parts of Australia.

Based on initial assessments, we do not consider high barriers to entry are restricting existing Australian insurers from entering the northern Australia market. As noted above, the barriers to establishing a new insurance business can be high, but there are lower barriers for an established insurer to move into a new region. As such, barriers to expansion should not be a motivating factor in insurers' decisions to not supply services in northern Australia. Instead, it appears that insurers are not supplying in northern Australia due to the higher risk and relatively small size of the market. However, we consider there is merit in investigating this issue further and it will be a focus area for the inquiry in 2019, as noted above.

Concentration risk is softening competition in high risk areas

As discussed in more detail in chapter 5, insurers try to limit their exposure in high risk areas (or their concentration risk) due to the losses that may be faced in the event of a catastrophe. That is, a relatively high market share in a particular geographic location is often seen as undesirable due to the potential for significant claims costs in the event of a catastrophe affecting the area. Insurers wish to manage their exposure in these areas to reduce the volatility in claims costs and profits. Limiting exposure in these areas can also help to manage reinsurance costs. As a result, in many high risk areas, insurers do not actively seek to increase their market share.

For example, in 2011, a senior manager at one insurer sought to increase premiums in far north Queensland more than what was proposed in the rest of the state due to concerns at the rate of growth in this area and in order to provide evidence to its reinsurers that it was seeking to slow growth in this area. As such it was proposed far north Queensland premiums would increase 40 per cent as opposed to the rest of Queensland at 18 per cent.

In many cases insurers are using pricing to reduce their risk concentration in an area, or in some cases, they may stop writing new business altogether. As a result, insurers place less competitive pressure on other insurers in high risk areas where they are trying to manage their exposure.

In 2016, competitor pricing analysis indicated one insurer was 'rather cheap' in the Pilbara region of Western Australia, and this gave explanation to the amount of business it was writing in the area. In order to arrest growth in this region, a senior manager approved premium increases across the insurers' brands.

While in 2011, an insurer implemented a strategy of not growing its aggregate exposures for strata properties in severe, high or extreme cyclone zones in Queensland. It did this by only writing new business that satisfied a certain criteria that fit its desired risk profile, and offsetting any new business by not renewing what it considered poorer risks. This included not writing any business in these regions for properties built prior to 1983, located in remote areas or islands, of inferior or non-massive construction and risks with a poor claims history.

The impact that this is having on price based competition, and insurance availability in northern Australia is discussed below.

Price competition in northern Australia

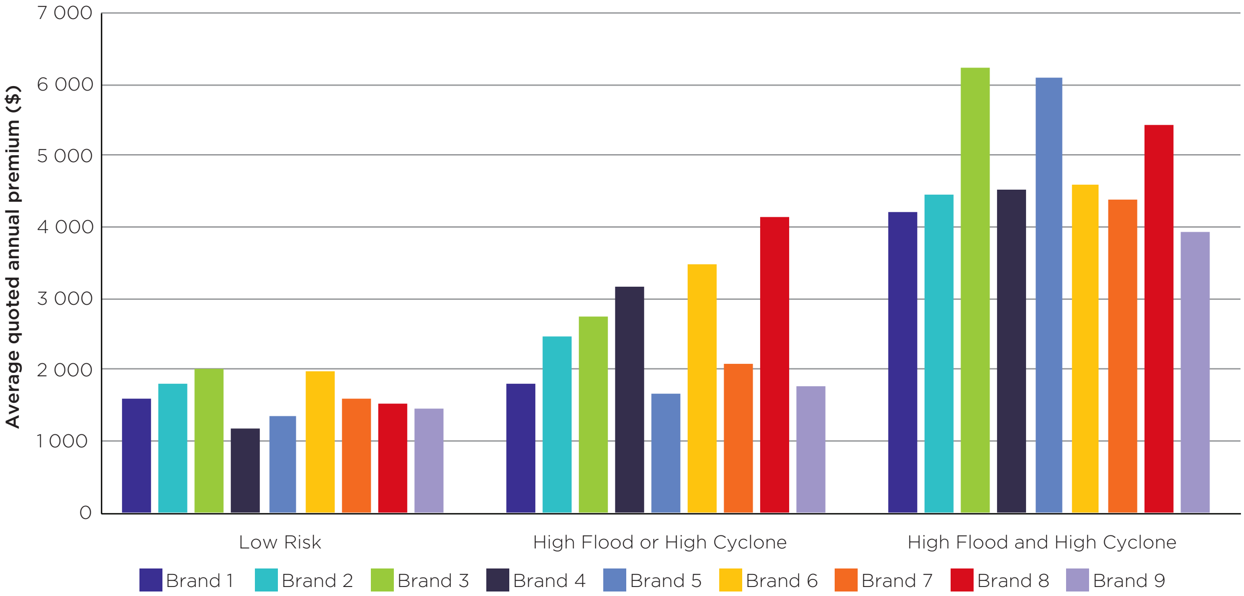
As discussed in chapter 3 and 5, greater pricing sophistication and pricing to reduce concentration risk have increased the spread of premiums paid by customers of individual brands within high risk postcodes in northern Australia.

As part of the inquiry, the ACCC obtained thousands of quotes from insurers for home, contents, and home and contents products and for multiple addresses. We received premium quotes from various insurers' brands for each address for differing risk profiles using the following combination of levels: 3 sum insured levels, 3 building construction years, 3 construction types, 2 policyholder age levels, and

3 excess levels. The quotes obtained were then aggregated to provide an average quoted premium for various insurers depending on the location of the properties and their exposure to certain risks.

As figure 7.7 indicates, low risk areas in north Queensland attract lower premiums and less varied quoted premiums than areas with high flood or high cyclone risk. The higher variability in average quoted premiums in high risk areas could reflect insurers having different assessments of those risks, different concentration risks or stronger branding and customer inertia in these areas.

Figure 7.7: Average quoted annual premiums for combined policies for residents in regions of north Queensland rated by peril risk, 2018

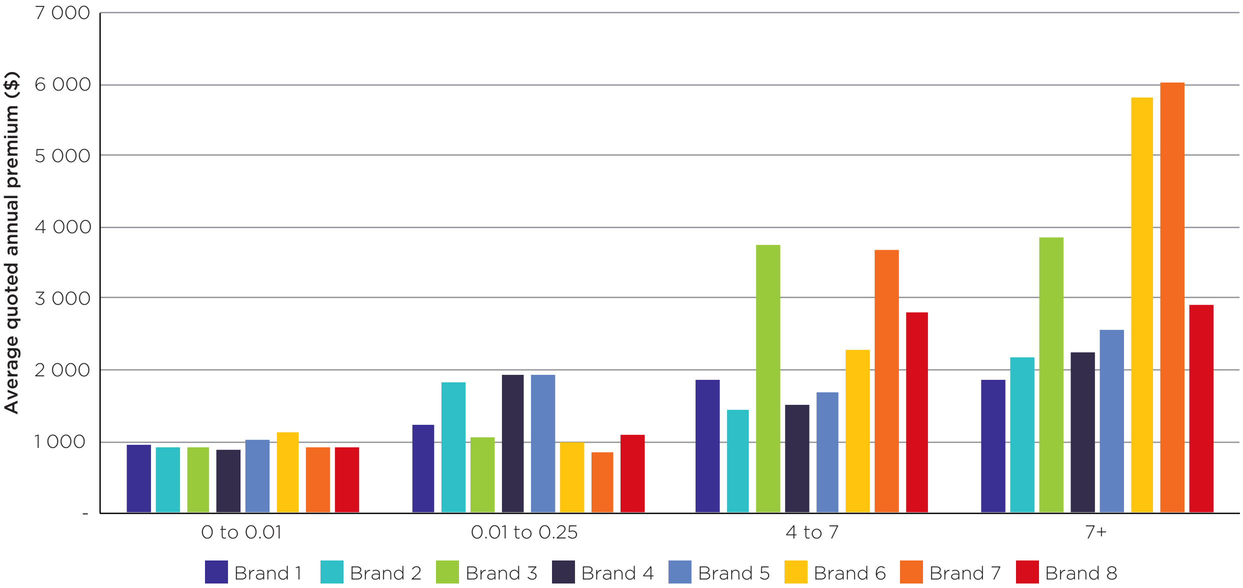


Source: ACCC analysis of data provided by Finity Consulting. Compares select brands. Peril risk based on Finity Consulting's assessment of natural peril based risk for all Australian addresses.

In addition to the variability illustrated in this chart for average quotes, each brand would be expected to have a range of quotes across different properties. This means the range of variability in quotes overall would likely be even greater than that shown in the chart. This indicates that for residents living in high risk areas, there can be potential opportunities to switch to a cheaper alternative.

We note that this pattern in quotes is not restricted to northern Australian insurance, as indicated by the quotes offered in Victoria where a key peril is fire. Figure 7.8 shows the quotes for combined policies offered by a set of brands operating in Victoria. A similar pattern to that described above occurs, with the lowest fire peril category having a low average quoted premium and very little variability in average quotes. The highest fire peril category has a higher average quoted premium (though not as high as for the 'High Flood and High Cyclone' category in north Queensland in figure 7.7) and also has significant variability in average quoted premiums between brands. While we have not explored Victorian insurance pricing in any detail, this suggests that significant differences in pricing exist in other high risk areas in Australia.

Figure 7.8: Average quoted annual premiums for combined policies for residents in regions of Victoria rated by bushfire peril risk, 2018



Source: ACCC analysis of data provided by Finity Consulting. Compares select brands. Peril risk based on Finity Consulting's assessment of natural peril based risk for all Australian addresses.[124]

While for many consumers in high risk areas there are potential price saving opportunities if they were to switch provider, we recognise that for many specific properties the number of brands or insurers offering coverage may be smaller and the potential gains from switching insurer may be smaller or not exist for everyone. In addition, as noted below, it is difficult to compare offers between different insurers and this is having an impact on peoples' likeliness to switch providers.

Insurance availability in northern Australia

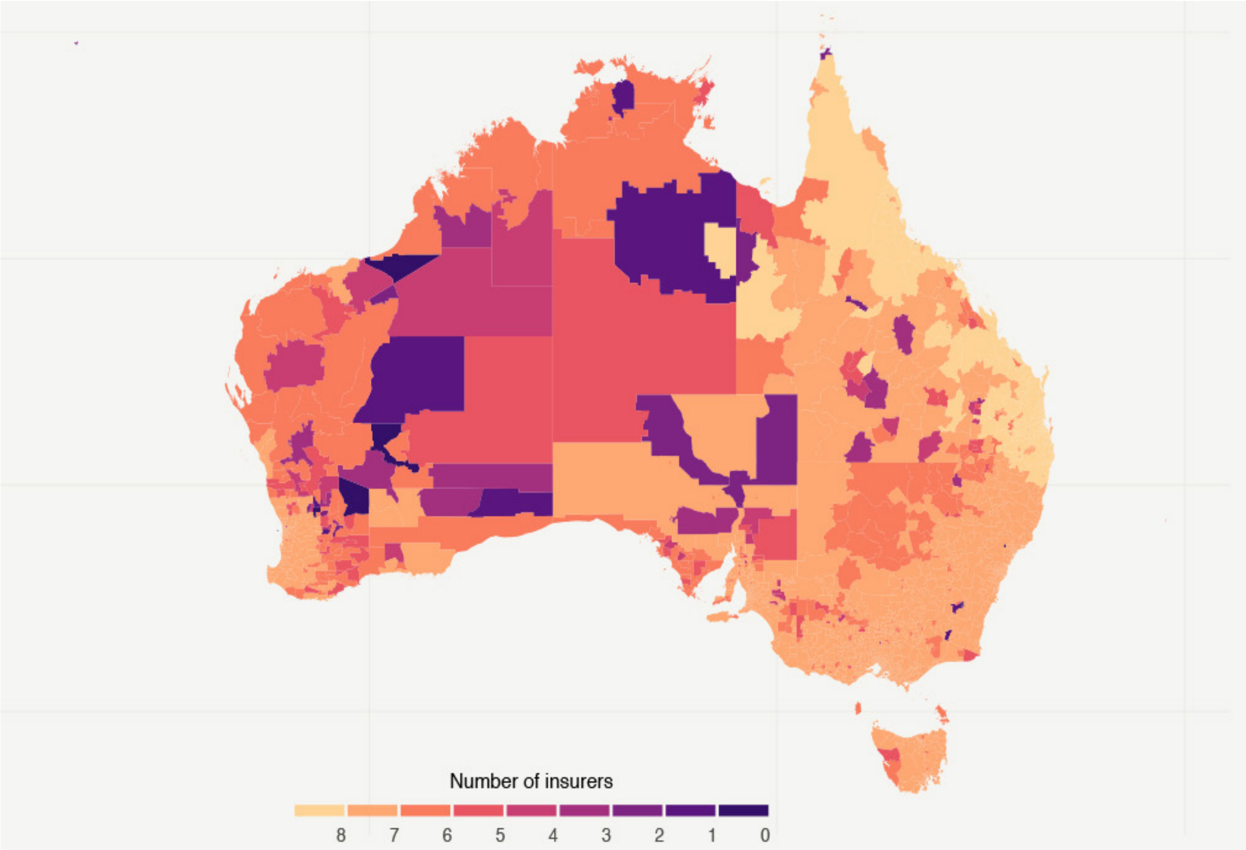
It appears that the number of insurers supplying in higher risk areas of northern Australia is also being impacted by insurers' decisions to manage exposure.

For many parts of northern Australia, it is possible to acquire home, contents or strata insurance, and that there is often choice between a number of insurers, brands and intermediaries. As shown in figure 7.9, information obtained during the inquiry indicates there were only five postcodes across northern Australia with a single insurer supplying insurance in the 2017–18 financial year. These were Tindal (0853), Wogyala (0862), Jabiru (0886), Lake Carnegie (6646) and Millstream (6716). These areas are sparsely populated and often concentrated on particular industries such as mining, tourism or defence.[125] For the majority of northern Australian residents there are four or more insurers supplying their postcode.

124 0 to 0.01: little to no bushfire risk (73 per cent of Australian addresses) 0.01 to 0.25: some bushfire risk (21 per cent of Australian addresses) 4 to 7: high bushfire risk (0.14 per cent of Australian addresses) 7+: very high bushfire risk (0.07 per cent of Australian addresses)

125 Based on information we obtained from insurers. Policy data supplied is at a postcode level. There may be parts of the postcode with fewer insurers. As this is only based on policies in force, there may be one or more actual suppliers willing to supply there postcodes that have no written risks.

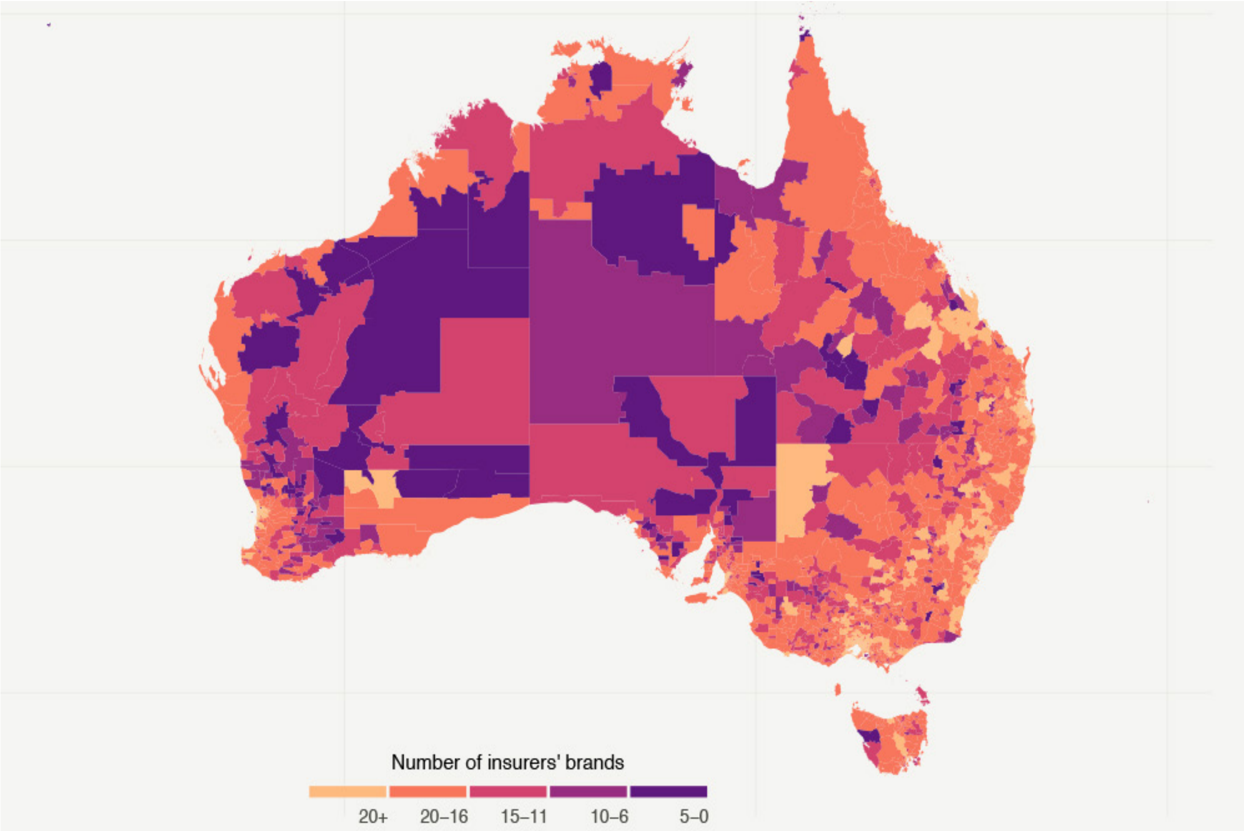
Figure 7.9: Number of insurers by postcode, 2017–18



Source: ACCC analysis of data obtained from insurers.

While, as noted in figure 7.10 below, the number of brands available to residents in northern Australia generally exceeds 10.

Figure 7.10: Number of insurers' brands (excluding intermediaries) by postcode, 2017–18



Source: ACCC analysis of data obtained from insurers.

While most postcodes currently have multiple insurers offering insurance, we have found that insurers often 'embargo' or 'redline' some high risk parts within postcodes or entire postcode areas.

Documents obtained from insurers show instances of insurers placing embargoes on certain new business in certain postcodes. This is often because it considers the area high risk (such as properties in a floodplain) and it wishes to reduce its exposure in the area. This is occurring in high risk areas in both northern Australia and high risk areas outside of northern Australia.

Box 7.1 Risk selection within a postcode

In 2014, an insurer identified 11 Queensland postcodes it considered suitable for address level embargoes due to an accumulation of flood risks. As a result, an embargo was placed on all high flood risk addresses within these suburbs. Addresses within these suburbs not considered a high flood risk could continue to purchase insurance from this company. This was predominantly for new business, and the insurer continued to provide insurance to existing high risk policy holders in the embargoed suburbs (around 1100 thousand policies) if no changes to the policy were made.

For residents in a floodplain looking to switch insurer, this resulted in one less supplier in the market.

This is discussed further in chapter 5.

Insurers avoid being the cheapest in some markets

The unpredictability of catastrophic events means the level of risk for a particular policy is not as certain as for other types of risk and results in insurers having less confidence in their pricing models. As a result, insurers routinely monitor prices offered by other insurers for particular risks with an eye to avoiding being the lowest priced insurer for that risk.

To do this, insurers generally obtain online quotes using automated systems that generate thousands of different quotes for a variety of different risk profiles.

The following examples show insurers increasing prices in response to movements in their competitors' prices.

One insurer noted after introducing flood cover that 'competitor monitoring and benchmarking will also play a key role in the defence of our existing portfolio profile', and increased premiums in north Queensland in response to competitor flood pricing to prevent 'negative risk selection'. Similarly, when another insurer introduced address based flood pricing, it conducted 'competitor pricing analysis' to review pricing in certain high risk areas and it made adjustments accordingly.

Some insurers monitor prices to maintain a market position. For example, we have seen one insurer adjust its pricing for one of its brands to maintain its position as one of the more expensive brands in north Queensland, because they saw the area as high risk. It described the strategy as a way of protecting the brand against negative selection. Since at least 2012, the insurer has made a number of adjustments to the brand's pricing in line with its strategy to position itself as an expensive insurer in north Queensland. For example, on discovering that its pricing was very competitive in Townsville and Proserpine, it increased the rates in the region for home insurance by 45 per cent, although price increases were capped for existing customers.

Another insurer found that after the 2010–11 Queensland floods, new business sales increased significantly, particularly in Queensland. The insurer determined that changes in its flood pricing approach were required to avoid further adverse selection. In 2012, the insurer noted that 'North Queensland premium adequacy is positive meaning prices are above their technical rates. In September 2011 we increased rates by 30 per cent above technical prices based on competitor monitoring and other commercial decisions.' However, the insurer also found that it was at 'the low end of the market', compared to its competitors, and as a result it recommended loadings in north Queensland of 20 to 45 per cent so that it would be at the 'higher end of the market'.

Recently, an insurer determined that it was under-pricing high flood risks in the Northern Territory based on monitoring of competitors' prices. It stated that, '[our] extremely competitive rates [are] the key driver fuelling the anti-selection for the NT portfolio. The key purpose of this price change is to realign [us] with the market.' This led the insurer to increase prices for around 2200 properties with the most significant increases to the high flood risk new business premiums.

On occasion, competitor modelling is used to calibrate an insurer's own models, or where the insurer has a lack of internal historic data. For example, when discussing the calibration of its flood premium pricing model, one insurer noted that 'given the absence of both reliable claims and industry data, competitiveness information was heavily relied upon to obtain a market view of the expected cost of flood across different levels of flood risk.' While another insurer noted in 2013, that 'the most obvious difference in our prices against our competitors, despite being premium adequate, is due to the lack of a more sophisticated rating engine which limits more accurate pricing.' Based on an analysis of competitor prices, the insurer determined that it was cheaper for older homes in cyclone areas, which are generally riskier than new homes. To deal with this, the insurer increased rates for all properties in north Queensland by up to 22 per cent.

Internal insurer documents also show that price increases from other insurers are seen as an opportunity to increase their own premiums.

Box 7.2 Increasing premiums in response to competitor pricing

On observing that competitors had increased premiums, senior managers at one insurer commented:

'We've got so much more upside than I realised. We need to address this but we need to be careful that people don't see it as us sneaking in further increases as part of flood...This makes me happy. I didn't realize we had so much opportunity.'

'I believe we need to be able to justify any increases. I can see regulators being interested and 'profiteering' allegations downstream...I'm not saying don't do it, far from it, I'm just saying lets have some good reasons including rising costs...of reinsurance, changing claims patterns and costs, reducing portfolio subsidisation blah blah.'

Overall, it appears that for higher risk areas insurers often try to avoid being the lowest priced insurer in the market, even where they have determined a technical premium based on the cost of providing the insurance.

It is difficult for consumers to compare insurers offers

Another indicator of limited competition, which applies not only to northern Australian insurance markets but insurance more generally, is the difficulty for consumers in making informed decisions and comparing insurance offers.

For competition in markets to be effective, consumers must be able to understand and compare insurers' offers. However, aspects of the way insurance is sold to consumers can create confusion and make it difficult for consumers to do this; including product complexity and disclosure requirements. These are discussed in more detail in chapter 9.

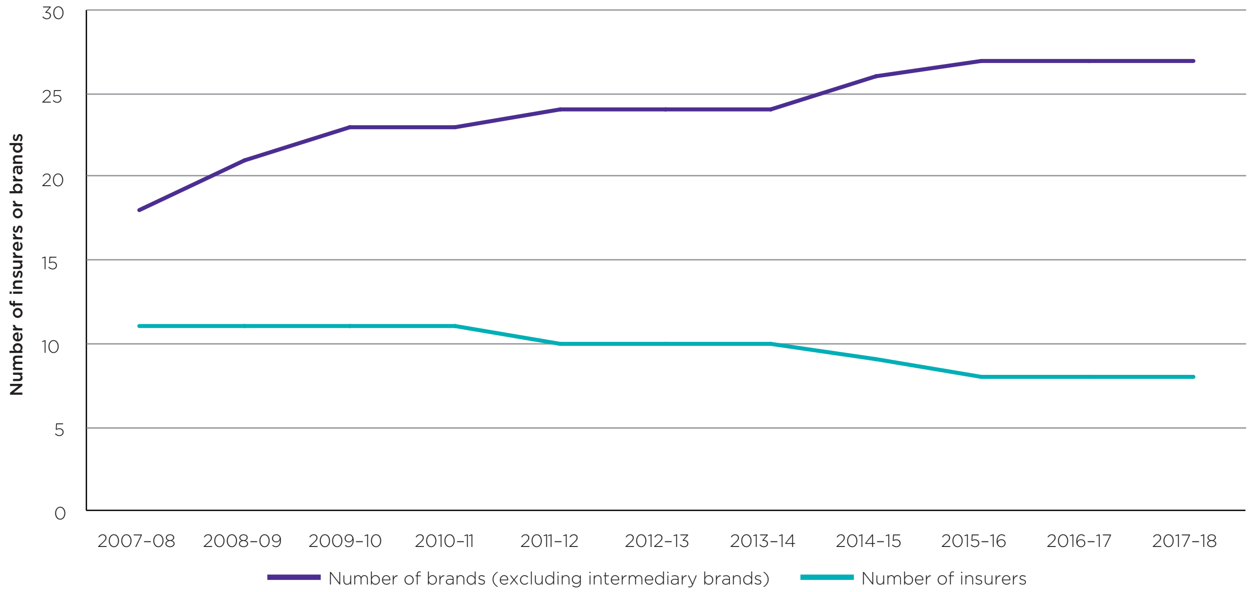
Other features of the market that are making it difficult for consumers to properly compare are complex products and the number of brands.

Brand confusion and diffusion

As discussed in chapter 2, distribution channels for insurance products can range from simple, single brand direct provision, through to the use of an intermediary arranging for insurance supplied under a brand name of a different intermediary.

In our June 2018 update report, we reported that approximately 45 brands and insurer intermediaries supply home, contents and strata insurance in northern Australia. However, information supplied by insurers more recently indicates that the actual figure is much higher than this at approximately 29 brands and 113 insurer intermediaries. Meaning from the eight insurers supplying home, contents and strata insurance in northern Australia, consumers could potentially see offerings from over 130 different brands and insurer intermediaries (taking into account strata only and broker only brands). As shown in figure 7.11, while the number of insurers supplying home and contents insurance has decreased from 11 to 8 over the last decade, the number of their brands has increased from 18 to 27.

Figure 7.11: Number of insurers and brands (excluding intermediaries) supplying home and contents insurance, 2007–08 to 2017–18



Source: ACCC analysis of data obtained from insurers.

In addition to the brands owned by the insurers there are many brands of intermediaries supplied by the insurers. While there is a degree of competition between these brands, the scope for competition is reduced as they ultimately source their products from the same smaller set of insurers.

Ultimately, the number of insurers, brands and intermediaries creates a perception that many more entities supply home, contents and strata insurance than in reality. For consumers, not knowing which insurer underwrites which brands or distributes through which intermediaries may result in a person inadvertently comparing only the brands and intermediaries of a single insurer or only a few insurers.

Obtaining and comparing quotes for insurance can be time consuming, and obtaining multiple quotes for brands using the same pricing models can waste consumers' time and effort. Further, in areas of northern Australia where the number of insurers writing new business may be limited, it is even more important that consumers are able to easily identify meaningful alternative offers.

The ICA has developed a website that is designed to address some of these issues. Its findaninsurer.com.au website is a referral website designed to help residents find a list of insurers who are offering the product they are seeking. However, this list is not exhaustive, is updated infrequently and does not give consumers an ability to see which insurers are active in their postcode.

A requirement for insurers to regularly report on the brands they underwrite, and the locations where they are active will help address these issues. This would also build on the Productivity Commission's recommendation in its recent inquiry into competition in the Australian financial system that insurers should provide an up-to-date list of the brands they underwrite to ASIC and that ASIC should transparently publish this information as a list on its website.

Recommendation 3: Insurers to report their brands and where they are writing new business

The Insurance Contracts Act should be amended to require insurers to report regularly to ASIC on the brands that they underwrite, and in which postcodes new business has been written for home, contents and strata insurance products.

This will provide greater transparency on which insurers underwrite which brands and assist consumers searching for alternative suppliers in their area. This would build on the Productivity Commission's recommendation in the recent inquiry into competition in the Australian financial system that insurers should provide an up-to-date list of the brands they underwrite to ASIC and that ASIC should transparently publish this information as a list on its website. (PC recommendation 14.2)

Consumers are unlikely to change providers

The ability of consumers to quickly and easily switch suppliers in response to price increases or service quality decreases is essential for effective competitive markets. Assessing the switching behaviour of consumers within markets helps determine whether consumers have ready access to acceptable substitutes for a product or service and are able and willing to switch supplier.

High retention rates are not necessarily indicative of limited competition, they may be a result of customer satisfaction and market leading offerings. However, if coupled with increasing prices and/or decreasing service quality, high retention rates may be indicative of high switching costs and lack of suitable alternatives. High switching costs may include search costs (the time and effort it takes to find a suitable alternative), transaction costs (expenses incurred by switching, such as exit fees or broker fees), or other market specific behaviour.

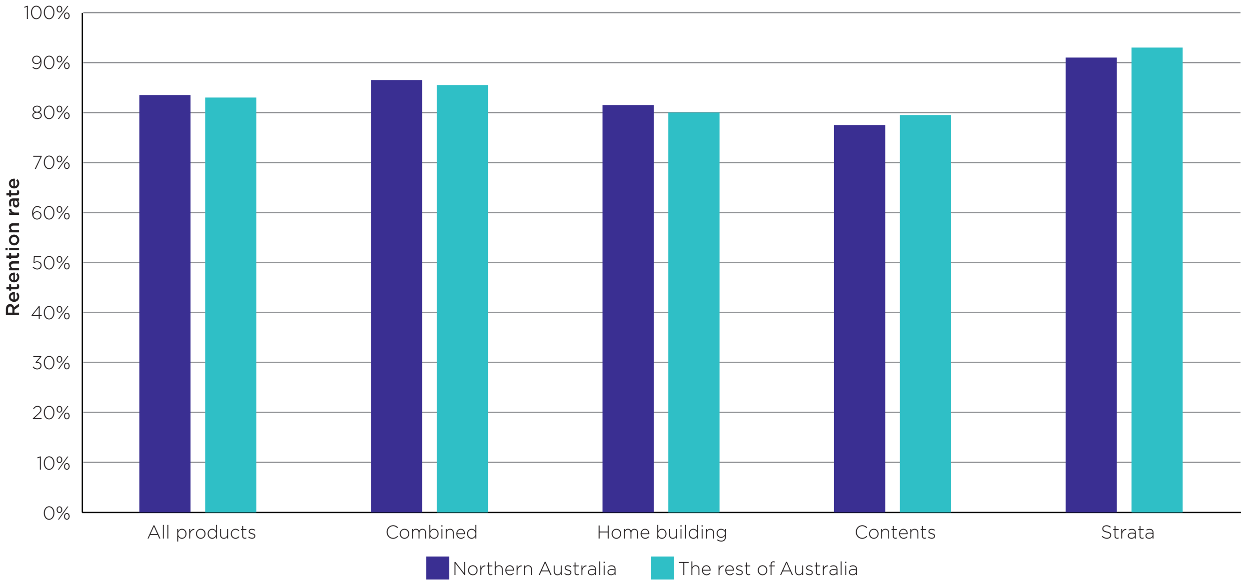
Insurance is often seen as a grudge purchase, a purchase that is often necessary but unwanted. Often the key driver behind a grudge purchase is price. However, for home and contents insurance, a strong driver behind consumer purchasing decisions appears to be brand reputation as shown by the dominance of brands linked to former state government insurers and automobile clubs.

Established insurers have traditionally been dependent on relative customer inertia, coupled with their size and brand value as a source of strength. The growth of challenger brands and the resulting loss in share by the majors as shown in figure 7.6 previously indicates that some consumers at least are switching to more aggressively priced competitors.

More generally, however, consumers of residential home and contents insurance tend to remain with an insurer for multiple years, resulting in high retention rates for insurers. National retention rates for home and contents insurers tend to be between 80–90 per cent. National home and contents retention rates also tend to be typically higher than retention rates for motor insurance, which tends to be between 70–80 per cent.

As shown in figure 7.12, retention rates between northern Australia and the rest of Australia are similar, with those purchasing combined policies generally switching less than those who purchase either building or contents policies. While retention rates are highest for strata products.

Figure 7.12: Retention rates by product for home, contents and strata insurance for northern Australia and the rest of Australia, 2017–18



Source: ACCC analysis of data obtained from insurers.

Customer inertia in markets for residential home and contents insurance may possibly be a result of high search costs. Currently, the only way for a consumer to receive an accurate quote is to either call an insurer or visit an insurer's website and answer multiple questions about the customer's property and contents. This then has to be repeated for many different insurers. Consumers may use an insurance broker to reduce these search costs, but this can increase transaction costs as products supplied through a broker will generally incorporate a commission fee.

A consumer may also use a commercial comparison website to reduce search costs, but these websites only provide quotes for participating insurers and the quotes provided are indicative only. Comparison websites and broker commissions are discussed further in chapters 9 and 10.

The impact of consumers' lack of switching on pricing

Customer inertia and price insensitivity appears to be having an impact on premiums as insurers in some markets struggle to entice customers to switch even though they may be priced significantly lower for that year. In one example, an insurer noted a competitor's brand was struggling to gain market share from one of its own brands, despite the competitor being priced 28–30 per cent lower.

This also heavily impacts on insurers' decisions to offer first year policy discounts to entice consumers to switch, as insurers are reliant on retention to return the customer back to a normalised price in the long term. Customers may also receive a lower renewal premium from their current insurer if they indicate a willingness to shop around.

Consumers who remain loyal to a single insurer have ended up paying higher premiums at renewal and continue to pay higher premiums compared to those who shop around for the best deal and regularly switched suppliers. This is despite the use of 'loyalty discounts' and 'no claim bonuses' as set out in chapter 5.

As noted in chapter 5, premiums for renewing customers can be higher compared to new customers. Reasons may include discounts for new customers being offset by renewing customers and insurers enhancing profitability by leveraging customer loyalty.

While reducing premium prices can attract new customers, there appears to still be a level of consumer distrust in premium prices that appear 'too cheap'. For example, in 2017 an insurer noted that rates for converting quotes to new business plateaued around 50–70 per cent regardless of how much cheaper their quotes were than their nearest competitor, indicating that other non-premium factors influence purchasing decisions.

In summary, we consider there are opportunities for many, but not all, consumers to obtain insurance at a lower cost by actively searching for and switching to alternative products that meet their needs. However, there are significant impediments to consumers doing this. These are discussed in chapters 8 and 9.

8. Product characteristics, terms and conditions

Key points

- The *Insurance Contracts Act 1984* (Cth) places obligations on insurers and their customers. It imposes duties of the utmost good faith and disclosure, sets out standard cover for a range of classes of general insurance, and requires insurers to provide consumers with certain information.
- The standard cover regime exists to standardise terms and conditions of insurance contracts and protect against a lack of coverage for events that consumers might commonly expect to be covered by their product. However a policy can (and usually does) provide more or less coverage than standard cover and the law allows this so long as insurers clearly inform their customers.
- Insurers' freedom to derogate from the standard cover regime should, in theory, allow insurers to offer the variety of policies that consumers demand, to the benefit of consumers. But this fundamentally relies on consumers being able to confidently identify the policies available that most closely offer what they want. We are not satisfied the current disclosure framework reasonably allows consumers to identify how seemingly comparable policies differ (an observation we build on in chapter 9).
- This difficulty in identifying derogations from standard cover is exacerbated by the proliferation in definitions used by insurers of the same key terms. Despite setting out the events that comprise standard cover, with the exception of flood, the law does not define these events. It is left to insurers to implement their own definition and communicate this to a consumer in the fine print of a product disclosure statement.
- In spite of the many ways seemingly comparable policies actually differ, industry continues to advocate for consumers to choose insurance policies based on an understanding of features, not just on price.
- In its review of the standard cover regime, we recommend that the Treasury develop a proposal to further standardise the definitions for prescribed events in the standard cover regime. They should also review the elements of standard cover with a view to incorporating common exclusions and limitations and mandating that insurers offer a product equivalent to the revised standard cover. These measures would make it easier for consumers to understand and compare insurance products.
- Consumer stakeholders say the duty of the utmost good faith (duty of good faith) does not go far enough to protect consumers and continue to advocate for the current exemption from unfair contract terms laws to be removed. We agree, and we made a submission on this basis to the Treasury's recent consultation on a proposed model of unfair contract terms law to apply to insurance contracts.

This chapter focuses on the non-price differences in home insurance products supplied throughout northern Australia, including coverage inclusions and exclusions and the lack of consistency in how insurers define certain terms. It considers the extent to which insurers derogate from the statutory 'standard cover' regime and the adequacy of existing requirements to disclose standard cover derogations. Finally, this chapter will consider the case for introducing unfair contract terms and how this will impact on the relative bargaining power of consumers and insurers.

8.1 What is an insurance contract?

An insurance policy is a contract between an insurer and a customer. The contract sets out the terms and conditions under which a consumer agrees to pay a premium to the insurance company, and the terms and conditions under which the insurance company agrees to compensate or indemnify a consumer for loss after an unforeseen event.

The *Insurance Contracts Act 1984* (Cth) (IC Act) places obligations on insurers and their customers. The purpose of the IC Act is to:

> ...improve the flow of information from the insurer to the insured so that the insured can make an informed choice as to the contract of insurance he enters into and is fully aware of the terms and limitations of the policy; and to provide a uniform and fair set of rules to govern the relationship between the insurer and insured.[126]

Most of the provisions apply to home, contents and some to strata title insurance. The IC Act imposes duties of the utmost good faith and disclosure, sets out standard cover for a range of classes of general insurance, and requires insurers to provide consumers with certain information.

The duty of good faith

All aspects of an insurance contract, from the time a policy is taken out to each party's responsibilities in the event of a claim, is subject to a duty on the parties to act in 'utmost good faith'. Section 13 of the IC Act requires both the insurer and the insured to 'act towards the other party, in respect of any matter arising under or in relation to it, with the utmost good faith'.

Although it is clear that the duty applies to both parties to an insurance contract, it is less clear what the duty entails. The IC Act does not define the duty of good faith but, as was observed in the *General Insurance Background Paper 14* to the Royal Commission (RC Background Paper), the High Court's 'judicial formulations of the duty' in *CGU v AMP* [127] are arguably definitional. The RC Background Paper sets out the formulation of the duty by Emmett J in the Full Court of the Federal Court in *AMP Financial Planning Pty Ltd v CGU Insurance Ltd*[128] (which decision was the subject of the appeal to the High Court) and the three formulations from the High Court. The RC Background Paper observes that these formulations are consistent in that:

1. [The duty has] no essential element of honesty. However, dishonest conduct would likely be a breach of the duty of utmost good faith
2. The standards are community (Full Court) and commercial (High Court) standards [of decency and fairness], and
3. 'Fairness', 'decency' and 'reasonableness' are relatively similar terms and arguably essential elements of the duty of utmost good faith. But the meaning of the duty goes beyond these subjective terms.[129]

The RC Background Paper also noted that the duty of good faith is not a fiduciary duty.[130] It may require an insurer to have regard to the interests of the consumer as well as its own interests, but unlike a fiduciary duty, the duty of good faith does not require the insurer to put the consumer's interests above its own interests.[131]

Given the lack of definitional certainty about the content of the duty, it is not clear what a consumer may need to show in order to establish that an insurer has not acted in good faith.

Furthermore, it is questionable whether a breach of the statutory duty by an insurer 'would ever add anything to damages flowing ordinarily from a contractual breach'.[132] Section 14A of the IC Act provides that, if an insurer has failed to comply with the duty of good faith, ASIC may exercise its powers under Part 7.6 of the *Corporations Act 2001* (Cth) to vary, suspend or cancel the insurers licence or make

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126 Senate Economic Reference Committee, *Australia's general insurance industry: sapping consumers of the will to compare*, August 2017, p. 12.

127 *CGU Insurance Ltd v AMP Financial Planning Pty Ltd [2007] HCA 36; AMP Financial Planning Pty Ltd v CGU Insurance Ltd* (2005) 146 FCR 447.

128 *AMP Financial Planning Pty Ltd v CGU Insurance Ltd* (2005) 146 FCR 447; 13 ANZ Ins Cas 61–658; [2005] FCAFC 185.

129 *General Insurance Background Paper 14* to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Dr Ian Enright; Peter Mann; Professor Rob Merkin QC; Greg Pynt, p. 92.

130 Ibid.

131 *AMP Financial Planning Pty Ltd v CGU Insurance Ltd* (2005) 146 FCR 447.

132 *General Insurance Background Paper 14* to the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, Dr Ian Enright; Peter Mann; Professor Rob Merkin QC; Greg Pynt, p. 93.

orders banning the insurer from providing financial services. However, there is no provision for financial penalties for a breach of section 13.

Consumer stakeholders say the duty of good faith does not go far enough to protect consumers and continue to advocate for the current exemption from unfair contract terms to be removed. Consumer Action Law Centre (CALC) has previously commented that the mechanism of the duty of good faith 'has proved inaccessible, ineffective, or both', and that 'it does not protect consumers from broad exclusions or other clauses in insurance contracts that would likely be "unfair"'.[133]

Disclosure obligations

Section 21 of the IC Act, the 'duty of disclosure', supports the duty of good faith. It requires a consumer wanting to enter into an insurance contract to disclose to the insurer everything that might influence the insurer's decision about whether to offer the insurance and on what terms. If a consumer fails to comply with this duty of disclosure, the insurer's liability for a claim may be reduced or avoided altogether.

The disclosure requirements insurers must meet are contained within the *Corporations Act 2001* (Cth),[134] the IC Act and the Insurance Contracts Regulations 2017 (IC Regulations).[135] Together they set out the specific information insurers must provide to consumers when they are purchasing a new policy, or renewing an existing one, which include a Key Facts Sheet (KFS) and Product Disclosure Statement (PDS).

We discuss the disclosure framework in chapter 9, where we consider in more detail how effectively current disclosure requirements are working for consumers. Throughout our consultation, we heard many local residents and property owners across northern Australia speak of their confusion about the detail of their policy and the inaccessibility of disclosure documents.

8.2 The concept of 'standard cover'

The IC Act defines certain classes of insurance contracts as 'prescribed contracts'. These are:

- home building
- home contents
- motor vehicle
- travel
- personal accident and sickness
- consumer credit.

The IC Regulations set out the standard cover terms and conditions of each of these classes of insurance.[136] If an insurer chooses to offer an insurance policy that is different from standard cover, whether by offering more cover or less, it must clearly inform a customer in writing of the change. Any variations are generally communicated through the PDS, however insurers are not required to expressly state how their policy differs from standard cover.

What is included in standard cover?

The standard cover regime exists to establish a standard level of cover for prescribed events, to be implied into the terms and conditions of certain classes of insurance contracts. Box 8.1 sets out some of the main inclusions and exclusions of the standard cover regime. Notably, the standard cover regime provides for total replacement cover (where claims are not limited by a nominated sum insured).

133 Senate Economic Reference Committee, *Australia's general insurance industry: sapping consumers of the will to compare*, August 2017, p. 65.

134 *Corporations Act 2001,* Chapter 7, Division 2, s. 941A(1).

135 *Insurance Contracts Act 1984* (Cth), Part 4, Division 4, ss. 33B(a)(b), 33C(1).

136 Insurance Contracts Regulations 2017*,* Part 3, Division 1.

The IC Act does not prescribe standard definitions of terms in the way it prescribes standard cover, with the exception of the term ‘flood’. There are several key product terms used by insurers that have different definitions between insurers. Inconsistent definitions make product comparability even more difficult and can confuse consumers about the level of coverage offered by a product.

Box 8.1 Summary of features of standard cover for home building and contents insurance

- The destruction of, or damage occurring to, the home building on the site, being destruction or damage that is caused by or results from the following prescribed events:
  - fire or explosion, or
  - lightning or thunderbolt, or
  - earthquake, or
  - theft, burglary or housebreaking or an attempt to commit theft, burglary or housebreaking; or
  - a deliberate or intentional act, or
  - bursting, leaking, discharging or overflowing of fixed apparatus, fixed tanks or fixed pipes used to hold or carry liquid of any kind, or
  - riot or civil commotion, or
  - an action of a person acting maliciously, or
  - impact by or arising out of the use of a vehicle (including an aircraft or a water-borne craft), or
  - storm, tempest, flood (within the meaning given by [the standard definition of ‘flood’ in] section 34), the action of the sea, high water, tsunami, erosion or land slide or subsidence.
- Accidental damage that is breakage of any fixed glass, fixed shower base, fixed basin, fixed sink, fixed bath, fixed lavatory pan or fixed cistern.
- The insured or a residing family member of the insured incurring a liability as owner or occupier of the home building to pay compensation or damages to some other person.
- Exclusions include:
  - depreciation
  - wear and tear, rust or corrosion, and
  - the action of insects or vermin.

Standard cover and strata insurance

Standard cover, as set out in the IC Regulations, applies to contents insurance held by residents of strata properties. It does not, however expressly apply to strata buildings.

The body corporate for the strata scheme will generally be required by state or territory strata legislation to insure buildings and building improvements to reinstatement or replacement value, which includes any costs associated with replacement, such as demolition, surveying, architectural or engineering work. They will also be required to take out public liability insurance for the common property.

As shown below, the specific requirements vary by jurisdiction but typically use terms also used in the IC Act and IC Regulations:

- **South Australia**—the *Strata Titles Act 1988* (SA), requires that insurance (for building and building improvements) must cover damage caused by the events declared to be ‘prescribed events’ in relation to home building insurance, apart from subsidence, listed under the IC Regulations.[137]
- **Western Australia**—the *Strata Titles Act 1985* (WA) and the Strata Titles General Regulations 1996 regulates residential strata insurance. The *Strata Titles Act 1985* (WA) outlines what the strata/body corporate company must insure for. It requires a strata company to insure and keep insured the building to the replacement value against fire, storm and tempest (excluding damage by sea, flood or erosion), lightning, explosion and earthquake.[138]

137 *Strata Titles Act 1988* (SA), s. 30.

138 *Strata Titles Act 1985* (WA), ss. 53D, 54.

- **Queensland**—the *Body Corporate and Community Management Act 1997* (Qld) governs the administration of community title schemes. There are also a number of regulations modules under this Act, the most relevant for building insurance being the Body Corporate and Community Management (Standard Module) Regulation 2008. This requires that a policy of insurance taken out for building/s must cover damage,[139] which is defined as:

    (a) earthquake, explosion, fire, lightning, storm, tempest and water damage

    (b) glass breakage, and

    (c) damage from impact, malicious act, and riot.[140]

- **Northern Territory**—there are two Acts which govern strata/body corporate schemes and the relevant Act depends on when the development was set up:
    - Unit plans registered from 1 July 2009 fall under the *Unit Title Schemes Act 2009* (NT) and Unit Title Schemes (Management Modules) Regulations. There are no prescribed events that must be covered under this Act or Regulations.
    - Unit plan registered prior to 1 July 2009 fall under the *Unit Titles Act 1979* (NT) and Unit Titles (Management Modules) Regulations. Under this Act a corporation shall insure and keep insured all buildings and other improvements for their replacement value from time to time against all the following risks:

    (a) fire, lightning, tempest, earthquake and explosion

    (b) riot, civil commotion, strikes and labour disturbances

    (c) malicious damage

    (d) bursting, leaking and overflowing of boilers, water tanks, water pipes and associated apparatus, and

    (e) impact of aircraft (including parts of, and objects falling from aircraft) and of road vehicles, horses and cattle.[141]

A submission to this inquiry indicated that consideration should be given to including additional prescribed contracts particularly in relation to strata buildings, arguing that prescribed contracts 'were written over 30 years ago so they could do with some 'modernisation' and should be reviewed'.[142]

How insurers innovate by varying products from standard cover

An insurance product can provide more or less coverage than standard cover. It is this freedom insurers have to innovate that contributes to the proliferation of variation between products. Of course product innovation can offer significant benefits for consumers and is necessary to ensure markets meet consumers' needs. However, for these benefits to be fully realised, consumers need to be able to understand how similar products differ and make comparisons between them.

We reviewed and compared the PDSs and KFSs of a range of insurance products supplied in northern Australia and all the policies we looked at do differ from standard cover.[143] In particular, they have varying exclusions and limitations on coverage, meaning that a consumer would need to carefully read the PDS to understand how the policies differed. Throughout our consultation, local residents and property owners across northern Australia repeatedly said how hard this was to do.

The main differences we identified from standard cover include:

- action of the sea—part of standard cover but excluded by most insurers
- high water—part of standard cover but excluded or limited by most insurers

139 Body Corporate and Community Management (Standard Module) Regulation 2008, ss. 178–180.

140 Ibid, s. 176.

141 *Unit Titles Act 1979* (NT), s. 80.

142 R. Bellert submission, p. 3.

143 PDSs and KFSs of insurers reviewed between September and October 2018.

- tsunami—part of standard cover but excluded or limited by most insurer brands
- erosion or landslide—part of standard cover but excluded or limited by most insurers
- accidental damage—this is offered by most insurers, but many offer it as either optional and for an extra cost or only as part of their more superior product
- flood—some insurers offer this as optional, depending on where the customer is located, while most insurers include it by default.

The standard cover regime set out in the IC Regulations generally provides for the contract to fully indemnify the consumer for the cost of the loss or damage. This type of cover is often referred to as 'total replacement cover'. For home building contracts, the standard cover regime provides for additional amounts for the reasonable costs of identifying and locating the cause of the damage, demolition and debris removal, and temporary accommodation.

As noted in chapter 9, only a small number of insurers currently offer total replacement cover, with most insurers limiting their liability to a nominated sum insured, a figure which is usually estimated by the consumer.

Many insurance products include coverage of some items or causes that are specifically excluded from standard cover, for example damage to electrical motors. These additional covers may be standard in some products or optional extras in others.

While consumers may select particular options in relation to an insurance product (e.g. additional coverage for certain events or items or level of excess), home and contents insurance contracts are typically presented on a 'take it or leave it' basis to consumers. Many local residents and property owners across northern Australia who participated in our public consultation used 'flood cover' as an example of this, with some saying they wanted to include flood insurance but couldn't afford to, and others saying they wanted to exclude flood cover but their insurer wouldn't allow them to opt out. They told us insurers were unwilling to do this.

Other product differences

Apart from the different types and levels of cover offered, other differences between products often exist. This adds to the complexity for consumers seeking to compare competing offers, particularly when such differences are inconsistently disclosed. For example:

- Additional excesses for particular events, which may or may not be listed in the KFS. For example, one insurer applies an additional $250 for each claim for loss or damage caused by an earthquake or tsunami, in contrast another insurer applies $300. During our consultation, we heard some people say a higher excess applied to their policy for a named cyclone. Some insurers list this excess in the KFS, other insurers do not or they may make a simple reference to there being an additional excess. However, all KFSs do have a general statement that 'A number of different excesses may apply in respect to this policy'. The specific details will usually be found in the PDS and/or the customer's certificate of insurance.
- Payment caps or limits on some home or contents items. For example, insurers will have a maximum limit for claiming on the loss of collections, sets and memorabilia. One insurer sets the maximum total claim limit to $5000 and another insurer sets this amount to $2000. The details of these limits are not generally provided in the KFS, other than the presence of a general statement that 'This policy has restrictions that limit your cover for certain events and items'.
- Specific features, such as removal of debris, either covered on top of the sum insured, or as part of it. For example, one insurer will cover up to 10 per cent of the building sum insured for any one event and another will cover up to 20 per cent. Some insurers will specifically stipulate in their KFS that this is an extra amount on top of the sum insured and make it clear in their PDS that this is the case. Other insurers are less clear.

Insurers also offer different tiers of cover. Most of the insurers reviewed offer at least two different levels of covers for both home insurance and contents insurance which generally consist of a basic and a more comprehensive product.

Is innovation working for consumers?

Freedom to derogate from the standard cover regime should, in theory, allow insurers to offer the variety of insurance policies that consumers are demanding. But the potential for this relies on consumers being able to confidently identify the products on the market that most closely offer what they want to buy.

If an insurer wishes to vary the terms of the insurance contract to derogate from standard cover, subject to the IC Act the insurer must 'clearly inform' the customer in writing of that fact before the contract is entered into. In practice, most insurers rely on the PDS and the accompanying KFS to do this. However the PDS does not need to specifically highlight any cover or exclusions that specifically fall short (or go beyond) of the prescribed standard cover.

The PDS outlines all the product inclusions and exclusions. It is generally a long and complicated document and it has been shown that many consumers do not read or understand it.[144] As outlined by several inquiry participants, the presentation of differing terms and cover in the current form of PDSs makes it difficult for consumers to assess their needs and make appropriate decisions. This also restricts product comparability, making it difficult for consumers to make like-for-like comparisons. This is exacerbated for disadvantaged or vulnerable consumers, such as consumers wither lower levels of literacy or for whom English is a second language.

iSelect outlined in its submission to the Senate inquiry that:

> PDSs are jargon-filled, excessively complex documents which make a like-for-like comparison between product offerings difficult. Too often, this complexity results in a customer basing their decision on price alone, which can result in insufficient or inappropriate cover.[145]

In a submission to the Senate Inquiry Mr John Rolfe also emphasised the difficulties that consumers face when trying to compare general insurance products using PDS documents:

> There are novels that are shorter than product disclosure statements. It is extraordinary. They run to 30 000 words. It would take hours to read just one of them. So let's say you were going to look at half a dozen of them before you picked an insurer. It is beyond belief that anyone would do that. So no-one is ever really going to know the detail of their insurance product.[146]

In 2012, the IC Act was amended to enable regulations to be made requiring insurers to provide a one-page KFS for home building and contents insurance policies. They are intended to provide increased simplicity, consistency and comparability for consumers when they are making decisions regarding insurance policies. Caution was provided in the Senate inquiry report that the KFS can oversimplify what is covered by a product and may give consumers a misleading impression. For example, Allianz noted that two distinct products can appear to offer the same insurance cover from the information provided in the relevant KFS when in fact they are very different.[147]

The National Insurance Brokers Association (NIBA) argued 'that the KFS has resulted in an oversimplification of what is covered by relevant policies and is therefore potentially misleading to consumers'.[148] For example, an insurer might suggest in its KFS that flood cover is optional but when you read the PDS it stipulates that this is subject to the insurer's approval. The examples provided above regarding 'other product differences' also demonstrate how information may be provided inconsistently across KFSs and provide the wrong impression about coverage. The combination of a KFS and PDS can also create confusion, given one document could be perceived as saying something different to

144 ICA 2017 research report, *Consumer research on general insurance product disclosure* found that most consumers don't read the PDS before purchasing a policy. ASIC commissioned research, Report 416, Insuring your home: Consumers' experiences buying home insurance, found that only two in every ten consumers who took out new insurance or considered switching read the PDS, but that 'reading' the PDS generally meant reading selected pages, not all of it.

145 iSelect submission, p. 5.

146 Senate Economic Reference Committee, *Australia's general insurance industry: sapping consumers of the will to compare*, August 2017, p. 40.

147 Senate Economics References Committee, August 2017, *Australia's general insurance industry: sapping consumers of the will to compare*, p. 40.

148 Ibid.

the other about product coverage. Chapter 9 explores concerns about the disclosure framework in more detail.

8.3 There is standard cover, but not standard definitions

Further limiting consumers' ability to make effective comparisons between policies is the lack of consistency in how insurers define certain terms. Despite setting out the events that comprise standard cover, with the exception of 'flood', the law does not define the terms used to label these events. Several submissions to this inquiry and the Senate inquiry argued that the inconsistent use of definitions goes against effective disclosure.

Flood is the only defined term in standard contracts

In 2008 the ACCC was approached by the Insurance Council of Australia (ICA) seeking an authorisation for a common definition of 'inland flood'. The ACCC was concerned that, to the extent that the proposed common definition introduced concepts which lacked legal certainty or applied concepts in a manner which may be inconsistent with their common meaning, the proposal may have the unintended consequence of increasing consumer confusion and diminishing the potential public benefits of the proposal.[149]

Our consideration at this time demonstrated that definitions must serve to provide clarity and create certainty. That is, they must not be to the detriment of consumers. The ACCC encouraged industry to consider refinements to the definition proposed by the ICA, however we were not asked to consider an amended proposal.

The Natural Disaster Insurance Review Panel conducted an independent inquiry into flood insurance and related matters following a series of natural disasters in 2010–11 which revealed large numbers of consumers were not insured for floods in the way that they expected (for example, they did not have it, sub-limits restricted payments and sums insured were insufficient). The panel made 47 recommendations to the Australian Government which included insurers being required to offer flood cover, and the introduction of a standard definition of 'flood' to reduce consumer confusion.

In April 2012, the IC Act was amended to implement a standard definition of flood.[150] In June 2012, the IC Regulations were amended to introduce the standard definition of 'flood' for certain insurance contracts, including home building, contents and strata title residences.[151] Insurers were given a two year transition period to comply, with the amendments taking effect on 19 June 2014.

Sections 18 and 22 of the IC Regulations state that standard cover in respect of home building and home contents insurance includes a loss that is:

> destruction of, or damage occurring to, the home building on the site (or the contents of the residential building which is specified in the contract, at a time when they are in the residential building or on the site of the residential building,) being destruction or damage that is caused by or results from: ...(xiv) storm, tempest, **flood (within the meaning given by section 34)**, the action of the sea, high water, tsunami, erosion or landslide or subsidence;...

The prescribed definition of flood cannot be varied by insurers.[152]

Although the introduction of a definition for flood is a positive step forward, and this was recognised by stakeholders in our public consultation, it does not deal with the broader problem of terms with differing definitions across policies impacting on product transparency and comparability.

149 See www.accc.gov.au/system/files/public-registers/documents/D08 per cent2B88443.pdf.

150 *Insurance Contracts Act 1984* (Cth), Part V, Division 1A, ss. 37A–E.

151 See the Insurance Contracts Regulations 2017, Part 3, Division 2, ss. 33–35.

152 Under s. 33(2) of Insurance Contracts Regulations 2017, the prescribed definition of flood may not apply to insurance contracts arranged by an insurance broker who is acting as an agent of the insured person. Insurance brokers are provided the flexibility to negotiate tailored insurance products based on risks.

Insurers do not have consistent definitions of other listed events

Consumer groups in particular expressed strong views about standardising definitions for key terms to assist consumers with comparability. CHOICE elaborated on this point, submitting to the Senate inquiry that:

> A good disclosure process can be defeated if key definitions are not standardised. This is particularly the case in insurance where a definition, potentially hidden 100 pages deep in a PDS, can radically alter the value of a policy.[153]

Margaret Shaw noted in her submission that:

> I know much more about insurance than I ever wanted to know and even I get confused at the wording. How do they [insurers] define flooding, storm surge, water ingressation, and what's the difference?[154]

In the absence of statutory definitions for common terms, it is unsurprising that the definitions developed and adopted by competing insurers can differ considerably. There is unlikely to be a competitive advantage for insurers in seeking to reconcile these divergent definitions.

A good example of the variation between insures is the term 'action of the sea'. CHOICE used this as an example in its submission to the Senate inquiry, advising that:

> ANZ excludes loss or damage caused by 'actions by the sea' however it does not define a tsunami as an action by the sea and will in fact cover loss or damage caused by a tsunami. By contrast Coles considers a tsunami to be an act of the sea and excludes damage or loss 'caused by high tide, tidal wave, tsunami or other actions of the sea'.[155]

We reviewed several PDSs and KFSs of insurers active in northern Australia and came across additional terms with inconsistent definitions. The KFS provides a brief description of events, but the details provided by each insurer will differ. Two examples of terms in insurer PDSs are provided in boxes 8.2 and 8.3 below, demonstrating how definitions can differ and create confusion for consumers, particularly those looking to compare products.

153 Senate Economics References Committee, August 2017, *Australia's general insurance industry: sapping consumers of the will to compare*, p. 38.

154 Margaret Shaw submission, p. 13.

155 Senate Economics References Committee, August 2017, *Australia's general insurance industry: sapping consumers of the will to compare*, p. 38.

Box 8.2 Example of how the definitions can vary: definition of 'Escape of liquid'

CommInsure's PDS definition covers 'loss or damage caused by the sudden and unexpected escape of liquid from any [of the following]:

- water main
- fixed water pipe (but not a garden hose)
- fire hydrant
- pool or spa
- fixed water feature
- fixed tank
- washing machine or dishwasher
- sink, basin, bath or toilet
- sealed portable heater, or
- fixed heating or cooling system'.[156]

RACQ's PDS definition refers to escape of liquid as 'leaks' from any of 'the following items or devices malfunction at or near your home and leaks from them cause loss or damage to your home or contents:

- dish and clothes washing machines
- water catchment trays in refrigerators, freezers and evaporative air conditioners
- waterbeds
- pipes, gutters and drains which are fixed or connected to your home
- fixed domestic items which include water tanks, lavatory cisterns and pans,
- baths, basins and sinks
- water mains'.[157]

156 CommInsure Home Insurance PDS, dated 18 February 2013, p. 41. General exclusions also apply regarding escape of liquid as listed in the PDS. Accessed 27 November 2018.

157 RACQ Household Insurance Policy, effective date 1 March 2017, p. 24. General exclusions also apply regarding leaks as listed in the PDS. Accessed 27 November 2018.

Box 8.3 Example of how the definitions can vary: definition of 'Impact'

RACQ's PDS definition covers:

- 'The impact of these items cause loss or damage to your home or contents:
  - a motor vehicle or watercraft
  - a tree or tree branch
  - an aircraft, space debris or debris from a rocket or satellite
  - a satellite dish, solar hot water tank or aerial.

The costs to remove and dispose of a tree or tree branch that causes the impact.'[158]

CommInsure's PDS definition (referred to as 'sudden impact') covers 'loss or damage caused by the sudden impact of:

- any rail or road vehicle, bicycle, watercraft, caravan or trailer;
- any aircraft or spacecraft;
- space debris or debris from an aircraft, rocket or satellite;
- broken or collapsed communications, aerials, masts, satellite dishes and/or power poles; or
- falling trees or branches, unless the damage or loss is caused directly or indirectly by tree or branch lopping or felling by:
  - you
  - a person who lives at your insured address, or
  - a person with your consent or the consent of a person who lives at your insured address'.[159]

8.4 Improving 'standard cover' and the use of standard definitions

In its submission to the Senate inquiry, NIBA advised

> It is critically important to note that each insurance policy can be, and most likely is, different. While there are standard cover provisions in the Insurance Contracts Act and the Insurance Contracts Regulations, insurers develop and offer their own terms and conditions of cover, and it should not be assumed that policies widely available for domestic insurance risks are identical in the cover they offer.[160]

NIBA and the ICA were among stakeholders who, in their submissions to our inquiry, encouraged consumers to focus on these non-price difference in selecting an insurance policy.[161]

These submissions come despite the extensive conversation in recent years, and highlighted through this chapter, about the difficulties that consumers face in trying to compare the detail of insurance policies. In chapter 9, we discuss the consumer experience in more detail.

In their submissions to our inquiry and the Senate inquiry, consumer representative groups raised the inconsistent use of definitions and the non-standardised nature of general insurance products as a barrier to product comparability, proposing standardisation of key product terms and a review of standard cover as a way of helping to address this issue.[162]

158 Ibid, p. 23. General exclusions also apply regarding impact as listed in the PDS. Accessed 27 November 2018.

159 CommInsure Home Insurance PDS, dated 18 February 2013, p. 52. Accessed 27 November 2018. General exclusions also apply regarding sudden impact as listed in the PDS.

160 NIBA submission to the Senate inquiry into *Australia's General Insurance Industry*, August 2017, p. 8.

161 NIBA submission, pp. 8–9 and ICA submission, pp. 32–33.

162 CALC submission p. 3; LAQ submission, p. 9; CHOICE submission to the Senate inquiry, p. 13; FRLC submission to the Senate inquiry, p. 30; CALC submission to the Senate inquiry, p. 10.

Industry has also recognised the value of this proposal with Allianz expressing to the Senate inquiry a general willingness of the industry to consider standardising definitions, remarking that:

> I think we would all agree that having a standard definition of flood has been of great advantage to the industry and to consumers. I do not think we would be averse to standardising some other definitions like actions of the sea in a similar way.[163]

Legal Aid Queensland (LAQ) also supported the standardisation of definitions, submitting that 'consumers have difficulty comparing offers [and] where terms are on their face similar, consumers are unaware of how each insurer may interpret an otherwise seemingly similar term'. LAQ suggested that standardising definitions would allow consumers to more easily compare products.[164]

We agree with this view and believe a greater capacity to compare, leads to better informed consumers which in turn drives competition.

While we support, in principle, measures that have the potential to genuinely improve consumers' capacity to compare seemingly similar products and make better informed choices, any approach must also carefully consider potential unintended consequences. For example, in the ACCC's initial consideration of an application to introduce a standard definition of 'inland flood' back in 2008, we did not grant authorisation of the definition proposed, citing concerns it could introduce more uncertainty.[165] Similarly, the definitions for related terms (for example, for types of 'action of the sea') should be crafted to avoid the potential for coverage gaps.

There is also the potential that a standardised definition can result in some insurers having to raise their level of cover to meet a new definition which, while improving coverage for consumers, can lead to higher premiums where insurers (and consumers) continue to provide (and purchase) cover for the risk affected by the standardised definition. A robust consultation process that represents consumers, industry and regulators helps ensure any proposed standardised definition achieves its objectives to improve consumer outcomes.

As part of the recent review of the General Insurance Code of Practice (the Code) the ICA consulted on draft best practice disclosure guidance for incorporation into the Code. The final report outlined consumer groups' submission to the review suggesting that the guidance should include the following additions:

- disclosure should promote consumer understanding of deviations from standard cover, and
- a commitment to standard definitions.[166]

The standard cover regime in its current form does not appear to be delivering the best outcomes for consumers and fulfilling the intention of the IC Act. That is, consumers are finding it difficult to make an informed choice and be fully aware of the terms and limitations of their product.

Making standard cover available to consumers

In its submission to the Senate inquiry, CALC contended that the standard cover regime for general insurance is not operating in line with its intended purpose and as such there are no minimum standards that a consumer can rely on in an insurance policy. As a result insurance lacks transparency. CALC also advised that standard cover has failed to address the significant problems people face when buying insurance and commented that the core problems which persist include comprehension, comparison and suitability.[167]

The House of Representatives Standing Committee on Social Policy and Legal Affairs found 'that deviation from the prescribed Standard Cover for general insurance has led to extensive confusion

163 Senate Economics References Committee, August 2017, *Australia's general insurance industry: sapping consumers of the will to compare*, p. 39.

164 LAQ submission, p. 9.

165 See www.accc.gov.au/system/files/public-registers/documents/D08 per cent2B88443.pdf.

166 Review of the General Insurance Code of Practice Final Report, June 2018, p. 34.

167 CALC submission to the Senate inquiry into *Australia's General Insurance Industry*, August 2017, pp. 2–3, 9–10.

for consumers over what a particular insurance policy covers'.[168] Consumer awareness of their policy coverage could be greatly improved if it could be compared against the reference of standard cover.

The Committee also reported that:

> Greater awareness of Standard Cover can be achieved either through making it mandatory for insurers to provide policies that meet Standard Cover, and through more easily understood and readily available disclaimers of derogation from Standard Cover than those that are currently given.[169]

Consumer groups have also expressed concern, particularly through the Senate inquiry, that there is no requirement for the insurer to explicitly state to a consumer how a product specifically derogates from standard cover. As noted earlier, insurers can comply with the requirement to 'clearly inform' a consumer when their product provides less (or more) than standard cover simply by providing them with a PDS.

At present, insurers are not required to provide a product fully consistent with standard cover. Such an obligation would give consumers a reference point when comparing products across insurers and brands.

However, given the prevalence of insurers applying specific limitations for prescribed events (either a dollar limit on coverage, or exclusions for particular causes), and the fact that standard cover provides, in effect, total replacement cover (not limited by a sum insured), a mandated standard cover product would usually represent an increase in coverage and quality compared to most of an insurer's existing products and would be priced accordingly.

While such products may suit the needs and budgets of some consumers, their likely cost in northern Australia would limit their appeal to most consumers and therefore their usefulness as a point of comparison between brands and insurers.

An alternative approach is to revise the terms of standard cover to incorporate common exclusions and limitations. This could result in a more affordable mandated standard cover product offering that would allow consumers to benchmark insurers against each other. Insurers will be able to offer other products with additional or fewer features in addition to this standard cover product. The product could include a standard excess (the national average is generally around $780 for home insurance and $400 for contents insurance) and a sum insured cover rather than total replacement cover. Sum insured is the option more commonly taken out by consumers (noting that some insurers do not offer total replacement). The specific product inclusions and exclusions of standard cover should be set with reference to prevailing market offerings, with a view to making standard cover provide an acceptable level of coverage for the majority of the population.

Where insurers chose to offer other products that deviate from standard cover, they could be required to:

- explicitly state what features are in addition to or derogate from standard cover
- the price difference between choosing standard cover and the alternative product.

Consumers would be made aware when they select an alternative product that in doing so they are adding or opting out of certain events and the relevant premium implications.

The recent Senate inquiry report recommended that the government initiate an independent review of the current standard cover with particular regard to the efficacy of the current disclosure requirements. It also recommended that the government work closely with industry and consumer groups to develop and implement standardised definitions of key terms for general insurance. The government agreed that there is merit in further reviewing these recommendations and tasked the Treasury with assessing these proposals.

168 House of Representatives Standing Committee on Social Policy and Legal Affairs, *In the Wake of Disasters, Volume One: The operation of the insurance industry during disaster events,* February 2012, p. 43.

169 Ibid, p. 93.

We strongly support the Treasury's review of the standard cover regime, including a proposal to introduce consistent definitions for additional key terms and make two recommendations listed below. These initiatives have the potential to alleviate confusion, enhance the comparability of products and more informed decision making and lead to greater competition in insurance markets.

Recommendation 4: Standardise definitions of prescribed events

The Treasury's review of the standard cover regime should develop a proposal to standardise the definitions of prescribed events (including 'action of the sea', 'impacts' and 'storm') to enable greater certainty for consumers and comparability of products.

New standard definitions should be drafted in a way that removes potential gaps in coverage between prescribed events, avoids the introduction of ambiguous concepts, and does not unnecessarily limit insurers' scope for future beneficial product innovation.

Recommendation 5: Review and mandate standard cover

The Treasury's review of the standard cover regime should develop a proposal to mandate that insurers offering home insurance/contents insurance products should also offer a home insurance/contents insurance product that does not deviate (through inclusions/exclusions) from the revised standard cover terms in the Insurance Contracts Regulations.

By ensuring there is one common product from each insurer (but not necessarily each brand), consumers could easily benchmark insurers against each other. This should not limit an insurer from offering other products that provide cover that differs from the standard cover product but insurers should be required to clearly indicate how these products differ from their standard cover product.

8.5 Should unfair contract terms apply to insurance contracts?

In 2010, unfair contract terms (UCT) provisions were inserted into both the *Competition and Consumer Act 2010* (Cth) and the *Australian Securities and Investments Commission Act 2001* (Cth) (ASIC Act). These laws are designed to protect consumers from unfair terms in circumstances where they have little or no opportunity to negotiate with the business, such as with standard form contracts. The UCT laws apply to most financial products and services but there is an exemption for insurance contracts regulated by the IC Act including home, contents and strata insurance.[170]

UCT laws also possess a number of other limitations. This includes that they do not make unfair contract terms illegal in standard form contracts. What they do is enable a potentially unfair contract term to be challenged in a court, and if it is judged to be unfair the court can declare that term to be void, meaning that it will no longer apply between the parties. The rest of the contract will continue to bind the parties to the extent it is capable of operating without the unfair term. The other limitation is that the ACCC (or ASIC) cannot seek civil pecuniary penalties when a term in a contract is found to be unfair and declared void by the court. Infringement notices are also not available as an enforcement tool.

Consumer stakeholders have consistently called for the removal of the exemption, including during our consultation.

In December 2017, the Australian Government announced that it would extend the unfair contract term provisions to contracts of insurance and in June this year, the Treasury released a Proposals Paper *Extending unfair contract terms protections to insurance contracts* with a proposed UCT model to implement this policy. The ACCC made a submission in strong support of removing the exemption and allowing for the courts to make other orders, such as ordering compensation, where a term is found to be unfair. These points are revisited at the end of this chapter.

170 Section 15 of the *Insurance Contracts Act 1984* (Cth) precludes the UCT laws in the *Australian Securities and Investments Commission Act 2001* (Cth) from applying to insurance contracts.

Previous reviews have consistently recommended extending UCT laws

Several recent reviews and inquiries have concluded the current exemption should be removed and UCT laws extended to insurance contracts, for example:

- In 2012, the House of Representatives Standing Committee on Social Policy and Legal Affairs concluded that the industry has not demonstrated a capacity to protect consumers under the current exemption and recommended the removal of the exemption and ensure its enactment by the end of 2012.[171,172]
- The 2017 Australian Consumer Law Review report found that while the IC Act contains its own protection for consumers, they are not the same as the UCT protections and have not been shown to provide equal or greater protection. The Review said this was inconsistent with the intention that the Australian Consumer Law operate as a generic, economy-wide law that minimises exemptions.[173]
- In August 2017 the Senate inquiry concluded the exemption is unwarranted and creates a significant gap in consumer protections. It recommended the government introduce the legislative changes required to remove the exemption for general insurers to UCT laws.[174]
- In March 2018, the Parliamentary Joint Committee on Corporations and Financial Services released its report into the life insurance industry. It recommended that section 15 of the IC Act be reformed to enable consumer protections, including UCT laws, to apply to general and life insurance contracts.[175]

How could a change benefit consumers?

Consumer stakeholders have vocally and consistently advocated for the removal of the exemption of insurance contracts from unfair contracts terms laws. They say the exemption creates a significant gap in consumer protections and leaves consumers in a position of vulnerability during a claims process, whereby insurers have all the knowledge and power to be the ultimate decision maker. Particularly for a product that is already as inherently complex as insurance, consumers need more clarity and more confidence that the law will protect them from any unfair terms in their contract.

Although LAQ acknowledged that UCT laws are unlikely to reduce premiums by any significant amount, it considers consumers should be provided with the same level of protection under the ACL, rather than a lesser protection under the IC Act.[176]

Financial Rights Legal Centre (FRLC) said that the exemption does not in any way benefit consumers and is not necessary to protect the industry. It also commented in its submission to the Senate inquiry that 'arguably insurance is the area where consumers most need protection from unfair terms because consumers insure their main assets.'[177]

CALC submitted that :

> There are currently few incentives for insurers to offer good-value and fair policies which provide appropriate cover...Fairer contracts would benefit consumers and insurers by:
>
> - preventing disputes about unexpected and unfair claims outcomes
> - increasing consumer trust and confidence in the insurance industry
> - levelling the playing field between insurers, so that cheap, poor-value and unsuitable products

171 House of Representatives Standing Committee on Social Policy and Legal Affairs, *In the Wake of Disasters, Volume One: The operation of the insurance industry during disaster events,* February 2012, p. 95.

172 As a result of this report, in 2012, the Australian Government announced its intention to legislate to extend the protections from unfair terms in the Australian Securities Investment Commission Act 2001 to contracts for general insurance, however the resulting bill, the Insurance Contracts Amendment (Unfair Terms) Bill 2013 (Cth) lapsed at dissolution of the House of Representatives in 2013.

173 Australian Government, 2017, *Australian Consumer Law Review,* Final Report, p. 53.

174 Senate Economics References Committee, August 2017, *Australia's general insurance industry: sapping consumers of the will to compare*, p. 65.

175 Parliamentary Joint Committee on Corporations and Financial Services (2018), Life Insurance Industry, p. 47.

176 LAQ submission, p. 12.

177 FRLC submission, p. 23, FRLC submission to the Senate inquiry into *Australia's General Insurance Industry*, August 2017, p. 29.

do not prevail, and

- providing for more efficient regulation of insurance, by aligning it with the regulation of other consumer contracts.[178]

In its submission to the Senate inquiry, CHOICE claimed that removing the exemption 'would address two problems: the quality of insurance products sold and the poor treatment of consumers after sale.'[179]

What sort of terms may raise concerns

In February 2018, CALC published a research report, *Levelling the playing field to make insurance fair*, on how extending the unfair contract terms regime to insurance would provide major benefits for Australians when they are buying or claiming on their insurance. CALC encouraged us to consider this report alongside their submission to our inquiry.

In its report, CALC gave examples of terms from actual PDSs that it considered could be unfair. We have reproduced one example from the report in box 8.4, which was also provided as part of CALC's submission to the Senate inquiry. We have also provided another example of a potential unfair term based on the proposed UCT model in box 8.5. These terms demonstrate the lack of consumer protections under the duty of good faith compared to a UCT regime, where such terms may be considered unfair.

Box 8.4 Example of potentially unfair contract term in insurer PDS—How to pay your excess

'When you make a claim we will choose whether to deduct the applicable excesses from the amount we pay you or direct you to pay the excesses to us or to the appointed repairer or supplier. We may require you to pay the excesses in full before we pay your claim or provide any benefits under your policy. The fact we have asked for payment of your excess does not of itself mean that your claim has or will be accepted by us either in whole or in part.'

In CALC's view, this and similar clauses are unfair because:

- The requirement to pay the excess before the claim is paid causes a significant imbalance between the consumer and insurer. Someone in financial distress, whose home has been damaged or completely destroyed, may not be able to afford to pay the excess. They will then not be able to claim the benefit they are entitled to.
- This requirement is also not commercially necessary. An insurer could instead deduct the excess from the benefit paid or, if the insurer pays to rebuild or repair the home, they could bill the consumer and/or allow the excess to be paid in instalments.
- This clause is also misleading for consumers. The IC Act does not allow an insurer to deny a claim based on what the consumer does after the contract is entered into, unless the consumer's actions cause or contribute to the loss. The General Insurance Code of Practice also entitles consumers to apply for financial hardship when making claims.[180]

178 CALC submission, p. 4.

179 Choice submission to the Senate inquiry into *Australia's General Insurance Industry*, August 2017, p. 14.

180 CALC submission to the Senate inquiry into *Australia's General Insurance Industry*, August 2017, p. 13.

Box 8.5 Example of potential application of unfair contract term model—cash settlement based on discounted rebuilding costs

The examples of potentially unfair terms in the proposed UCT model are proposed to include terms that permit the insurer to pay a claim based on the cost of repair or replacement that may be achieved by the insurer, but could not be reasonably achieved by the customer. Without pre-empting whether such terms are in fact unfair, there is some potential for cash settlement clauses that provide for discounted rebuilding costs to fall for consideration under the UCT model.

Cash settlement clauses set out how an insurer will decide the amount to be paid.

Where an insurer has decided to settle a claim through a cash settlement it will generally be through a one-off cash payment as determined by the insurer.

For example, an insurer may have a policy that stipulates they will pay the consumer what it would cost the insurer to repair or rebuild. Some insurers provide further information qualifying what they mean, such as:

- the cash amount will be what the insurer determines to be the reasonable cost of repairing or rebuilding
- the cost determined by the insurer may include discounts that would be available should the insurer have undertaken the repairs or rebuild.

Such clauses may allow the insurer to pay a consumer an amount that differs significantly from the real costs for the consumer to rebuild their home. Should a consumer lose their home, an insurer may obtain a quote on the rebuild inclusive of their trade discounts and pay that discounted amount as a cash settlement, leaving the consumer in a vulnerable position.

The Treasury's 2018 Proposals Paper also outlined the same contract terms as being problematic and potentially disadvantaging consumers.[181]

Why do insurers want to retain the exemption?

Several industry stakeholders indicated in their submissions to our inquiry that they do not support the removal of the exemption and/or consider that there is sufficient protections for consumers under the IC Act.

The ICA has previously argued there are ample protections for consumers under the existing legislation, a view that IAG agreed with.[182] Suncorp also supports this view stating in its submission to the inquiry that:

> [they] recognise the importance of UCT legislation for most consumer contracts. However, there are already a range of strong consumer protections in place for insurance contracts, including the duty of the utmost good faith set out in the Insurance Contracts Act.[183]

While the IC Act contains some protections for consumers (such as the duty to act in the 'utmost good faith' and specific disclosure requirements discussed earlier), these are not equivalent to the protections that would be offered by UCT laws.

The duty of good faith may be of some assistance to consumers in their dealings with an insurer pursuant to their contract, although still fairly limited, and will not prevent the terms of that contract being unfair (in the insurers favour) in the first place.

CALC reviewed 147 Financial Ombudsman Service (FOS) decisions, from July 2013 to December 2017, involving allegations of a breach of the duty of good faith. Insurers alleged that the consumer had breached its duty in 83 per cent of these cases (due to fraud, being misleading or untruthful, non-disclosure or not co-operating). FOS found that the consumer breached the duty in only

181 The Treasury's 2018 Proposals Paper *Extending unfair contract terms protections to insurance contracts*, p. 8.

182 Proof Committee Hansard, 12 April 2017.

183 Suncorp submission, p. 31.

38 per cent of cases. In only three cases, did the consumer successfully claim that the insurer breached its duty of good faith.[184]

Suncorp also argued in its submission that:

> Any changes to unfair contract terms protections need to be developed carefully and in close consultation with the industry, or they risk jeopardising customer experiences and adding unnecessary complexity to insurance processes...The removal of the UCT exemption could change the scope of the coverage provided, and global reinsurers will view this as being non-industry standard policy wordings. This will increase the price that Suncorp would need to pay for reinsurance coverage putting further pressure on premiums.[185]

We note in response that UCT provisions already apply to insurance contracts in several jurisdictions including the United Kingdom, European Union and New Zealand. The main aspects of these laws are broadly similar to Australia's UCT framework.

The ACCC supports the current proposal to remove the exemption

On 18 December 2017, the government announced in its response to the Senate inquiry that it will extend the UCT provisions to contracts of insurance. On 27 June 2018 the Treasury subsequently released its Proposals Paper with options for implementing this policy decision.

The ACCC made a submission to this consultation, setting out our strong support to the extension of UCT protections to insurance contracts. We agreed that extending UCT protections to insurance contracts is an important step forward in ensuring consumers (and small businesses) can remedy unfair terms and that providing consistent economy wide protection should be the primary goal of this process. We provided comments on the proposed model including regarding remedies. As already noted the current remedy when a term is declared to be unfair, is that the term is void. We agree with the Proposals Paper's conclusion that in some circumstances this remedy may not be appropriate and the court should have the ability to make other orders. We called for including an express prohibition, civil pecuniary penalties and infringement notices in the new model. This will ensure more adequate protection for consumers and small businesses.

The ACCC's submission and the Treasury's Proposals Paper is available on the Treasury's website.[186]

Recommendation 6: Unfair contract term protections should apply to insurance

The unfair contract term protections in the Australian Securities and Investments Commission Act should apply to insurance contracts regulated by the Insurance Contracts Act.

The government is currently consulting on this change (which it has agreed to in principle).

It is important that insurance terms can reasonably balance the interests of the insurer and their customer. The inclusion of insurance contracts as part of UCT laws will close the gap and ensure that consumers are provided with the same UCT protections already available to consumers who have taken out other financial products and services.

184 *Levelling the playing field to make insurance fair*, CALC, February 2018, p. 8.

185 Suncorp submission, p. 31.

186 See treasury.gov.au/consultation/c2018-t284394/.

9. Consumer information and choices

Key points

- Local residents and property owners across northern Australia participated in our inquiry with a high degree of emotion. They are very concerned about the affordability of insurance and the impact this is having on the liveability of their community.
- We heard about significant rises in premiums and how worried consumers are that they will no longer be able to afford insurance. They are anxious about the risks they face if they are under-insured or not insured. Many people told us they had already tried everything to keep their premiums affordable but were now uninsured.
- Consumers wanted insurers to explain how they were assessing risks, how premiums were being set and why they were increasing. They wanted an opportunity to challenge what an insurer was telling them. The lack of transparency around pricing was a concern shared by many individuals and organisations who made submissions to our inquiry.
- Consumers seem willing to shop around, but we heard people say that comparing insurance policies was difficult and time consuming. They often lacked confidence to understand exactly what they were covered for and how to compare policies.
- Despite the complexity of policy documents and lack of pricing transparency, the insurance industry continued to advocate for consumers not just to focus on price but on the detail of competing policies. Consumers found it difficult not to focus primarily on price.
- A number of important reviews, inquiries and research over the past five years have highlighted shortcomings in current practices and requirements of disclosure in the general insurance industry.
- We welcome work currently underway to implement a number of initiatives to improve the transparency and usefulness of information provided to consumers and we make a number of additional recommendations to this end.
- Choice is a fundamental driver of competition and many local residents spoke of little choice and said some insurers were simply declining to quote in their area. We heard some strata buildings are currently without insurance (in breach of their legal requirement) due to a lack of willingness by any insurer to offer coverage.
- More granular data, and increasingly sophisticated analysis of that data, is allowing insurers to identify and understand risks more clearly. This offers significant benefits to the community through improved risk identification, product innovation, and mitigation opportunities, but it also raises new concerns with issues of data access, sharing, and privacy. It also raises concerns about asymmetry of information – when insurers know much more than consumers.
- There are opportunities for more effective education to ensure communities understand the role and limitations of hazard data prepared by councils and other government bodies, and how this complemented and/or differed from that relied on by insurers to set premiums.

Throughout our public consultation, local residents and property owners across northern Australia repeatedly expressed their concern and anxiety to us. People spoke of insurance premiums rising substantially, pushing them into real financial distress. Some said they couldn't afford to stay in their town, but they couldn't afford to go. They were worried for the future of their community. They spoke of governments wanting people to live and work in regional Australia, but that the cost of living there was becoming prohibitive. They told us they were confused about how their premiums were being set and why their premiums were changing so significantly year on year. They wanted more choice, more transparency, more clarity and most importantly, what they considered to be more affordable premiums.

This chapter considers how consumers receive, access and use information to make decisions about their home, contents and strata insurance policies and how insurance decisions can be made easier for consumers. It also considers how local residents and property owners across northern Australia, and more generally, respond to the pressure of rising premiums and what we know about under and non-insurance. We also introduce the role of data in insurance, a topic which is taken further in chapter 12 (mitigation).

9.1 Towards transparency and effective disclosure: challenges and opportunities

Insurers and intermediaries are bound by a regulatory framework which sets out the content, form and timing of information that must be provided to consumers. While the general insurance disclosure framework has evolved in recent years, we commented in chapter 8 that its effectiveness in helping consumers to understand their insurance options and make appropriate choices continues to be challenged.

Effective disclosure is essential to an effective consumer protection regime. Industry has widely acknowledged that delivering information at the right time, and in the right way, to improve decision-making, is complex. It is a challenge for consumer contracts of all kinds around the world.[187]

The current disclosure framework

Insurers and intermediaries must comply with a number of specific and general disclosure requirements. The disclosure framework is in addition to a broad range of consumer protection measures set out in the ASIC Act that apply generally to consumer financial products and services, such as prohibiting unconscionable conduct, misleading or deceptive conduct, and making false or misleading representations.[188]

The Corporations Act 2001 (Cth) prescribes the content that must be covered in a Product Disclosure Statement (PDS), such as its terms, conditions, limits and exclusions. Insurers must provide a PDS at the point of sale. When insurance is sold through an intermediary such as a broker, the intermediary must provide the consumer with a Financial Services Guide (FSG). An FSG must disclose information about the financial services offered, remuneration arrangements (such as commissions), and any potential conflicts of interest. The FSG can be combined with the PDS in a single document.[189]

Consumers also receive a certificate of insurance or policy schedule including details about the type of insurance cover, the sum insured amount, excesses that apply, some important exclusions and limits, the premium and the period of insurance.

In 2012, the Insurance Contracts Act was amended to enable regulations to be made requiring insurers to provide a one-page Key Facts Sheet (KFS) for home building and contents insurance policies. The Insurance Contracts Regulations 2012 prescribe the content, format and information that must be included in a KFS. As we mentioned in chapter 8, KFSs are an initiative intended to provide consumers with more simplicity, consistency and comparability. However consumer advocacy groups continue to question whether they are, in fact, helping consumers or just over-simplifying important information to fit within the prescribed format.[190] The government accepted the recommendation of the Senate Economics Reference Committee to review KFSs.

187 ICA submission, p. 32.

188 *Australian Securities and Investments Commission Act 2001* (Cth), ss. 12(ca), 12(cb).

189 Senate Economic Reference Committee, *Australia's general insurance industry: sapping consumers of the will to compare*, August 2017, p. 28.

190 See for example, statement from Ms Kelly of the Financial Rights Legal Centre to the Senate inquiry about KFSs 'It had a good intention, but it was not consumer tested. What we have seen, and we have reviewed hundreds of key fact sheets over the years of various products, is that some of them are so poor they just say, 'Refer to your product disclosure statement'; others are almost misleading with oversimplification of what is in them. In my experience of answering the hotline, and I have answered thousands of calls, only one consumer has ever raised it with me as being something that has actually informed them about their cover. In my view, it does not meet the intention it was designed or suggested to try and meet'. (Senate inquiry report pp. 39–40).

In addition, general insurers and brokers can choose to be members of the respective voluntary codes of practice which set standards of service for their industry:

- The General Insurance Code of Practice 2014 is maintained by the Insurance Council of Australia (ICA).
- The Insurance Brokers Code of Practice 2014, is maintained by the National Insurance Brokers Association (NIBA).

The codes generally address standards that are not specifically dealt with in legislation, for example in relation to customer service, claims handling and complaint and dispute resolution. Unlike the General Insurance Code, the Insurance Brokers Code reiterates that it is an obligation of brokers to act in a consumer's best interests at all times. We discuss the General Insurance Code further in chapter 11 on claims processes and dispute resolution.

Previous reviews and research repeatedly find problems with disclosure

In 2010–11, there were a significant number of natural disasters in Australia, including severe flooding in Queensland, New South Wales and Victoria. The number of people adversely affected by these natural disasters as a result of inadequate insurance cover exposed problems in consumers' understanding of their insurance.[191]

In the aftermath of these disasters, a string of significant reviews involving the general insurance industry (set out here) consistently made findings and recommendations around improved guidance and a more effective disclosure framework so consumers are better equipped to make informed decisions.

ASIC released two reports in 2014 exploring consumers' experiences with the sale of home insurance. Its first report found that insurers' sales processes are generally designed around insurers' need to understand certain risks or underwriting criteria about consumers so that they can sell home insurance quickly and efficiently to a consumer, rather than improving a consumer's understanding of the home insurance they are inquiring about.[192] ASIC also found that only two in every ten consumers who took out new insurance or considered switching read the PDS, but that 'reading' the PDS generally meant reading selected pages, not all of it.[193]

The 2014 *Financial services inquiry* considered the role insurance played in Australia's financial system. The Inquiry found that mandated disclosure regarding insurance products was not sufficient to allow consumers to make informed financial decisions. Disclosure can be ineffective for a number of reasons, including consumer disengagement, complexity of documents and products, behavioural biases, misaligned interests, and low financial literacy.[194]

In response to these concerns, the ICA established a taskforce to lead an industry project on effective disclosure. The Effective Disclosure Taskforce made 16 recommendations in its 2015 report titled *Too long didn't read: enhancing general insurance disclosure*. The Taskforce found the insurance disclosure framework centred on the provision of information without much regard for the consumer's ability to usefully apply that information to choose a policy suited to their needs. The recommendations include carrying out market research to understand consumers better and to guide efforts to improve PDSs.[195]

The Productivity Commission's inquiry into *National disaster funding* also highlighted the importance of effective information disclosure for insurance, noting that consumers may not make efficient choices without relevant and understandable information. The report also noted the implications that a lack of consumer understanding about their personal risk and insurance coverage can have with regard to underinsurance or non-insurance.[196]

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191 *Natural Disaster Insurance Review—Final Report*, September 2011, p. 1.

192 ASIC Report 415, *Review of the sale of home insurance,* October 2014*,* p. 6.

193 ASIC Report 416, *Insuring your home: Consumers' experiences buying home insurance*, October 2014, p. 45.

194 *Financial System Inquiry—Final Report,* November 2014, p. 193.

195 Insurance Council of Australia report, *Too Long; Didn't Read*, October 2015, p. 25.

196 *Productivity Commission Report on Natural Disaster Funding—Final Report, vol. 2*, May 2015, pp. 434–436.

While the Northern Australia Insurance Premiums (NAIP) Taskforce was established to consider options to lower premiums in northern Australia, it also found weaknesses in communication between insurers and consumers. It recommended the industry should engage more effectively with property owners in northern Australia, saying this requires improved disclosure of risks and greater responsiveness to policyholder concerns. The Taskforce went on to say there is also potentially a role for legislating enhanced requirements around the disclosure of risks if industry efforts do not achieve meaningful results for consumers.[197]

In its 2017 research report, *Consumer research on general insurance product disclosure* the ICA found that most consumers don't read the PDS before purchasing a policy. Most consumers believed they had considered all of the details when buying insurance, even though most do not look into exclusions and limits. Policy renewal letters were the most trusted and commonly used document for insurance customers. While most consumers were *confident* they understand the detail of their policy, the research suggested consumers' *actual* understanding of exclusions and limits were poor.[198]

The Senate Economics References Committee released its report (the Senate report) into the general insurance industry in August 2017.[199] The report made 15 recommendations on a range of issues, including the transparency of pricing, disclosure and competition in the general insurance industry. The Committee singled out the complexity of information as a particular issue, saying it was 'deeply concerned' by the apparent lack of transparency with regard to product disclosure, and the detrimental effect this has on consumers' ability to effectively compare policies.[200] It said that despite efforts by the sector to improve disclosure, more needed to be done.

As we discuss throughout the remainder of this chapter, we repeatedly heard from local residents and land owners across northern Australia that understanding insurance is hard. Comparing policies is hard and time-intensive. That insurers are unwilling, or sometimes unable, to provide guidance to meet consumers' needs. We can see this is creating real barriers for consumers who genuinely want to be engaged and make active and informed choices about their insurance cover and we make a number of recommendations to make it easier for consumers to engage.

In announcing its response to the NAIP Taskforce final report, and also the Senate Report, in December 2017, the government indicated it would be proceeding with a set of reforms recommended by the Senate Committee to place downward pressure on insurance premiums through increased accountability and transparency within the industry, as well as proposals to increase consumer understanding of insurance.[201]

A number of the recommendations agreed to by the government to improve consumers' understanding and access to information through better transparency and enhanced disclosure practices in the insurance sector have been referred to the Treasury to develop proposals.[202] We are making a number of recommendations that are relevant to these issues and will maintain an active interest in any proposals developed by the Treasury:

- strengthen the transparency of general insurance pricing by amending the product disclosure regime in the Corporations Act to require insurers to disclose the previous year's premium on insurance renewal notices; and explain premium increases when a request is received from a policyholder (Senate Committee recommendation 3, see also ACCC recommendation 10 in this chapter)
- review component pricing to establish a framework for amending the Corporations Act to provide component pricing of premiums to policyholders upon them taking out or renewing an insurance

197 *Northern Australia Insurance Premium Taskforce—Final Report*, November 2015, p. 89.

198 Insurance Council of Australia, Media release: Cutting-edge consumer research points insurers towards sharper customer engagement, 17 February 2017.

199 Senate Economic References Committee, *Australia's general insurance industry: sapping consumers of the will to compare*, August 2017.

200 Senate Economic References Committee, *Australia's general insurance industry: sapping consumers of the will to compare*, August 2017, p. 41.

201 kmo.ministers.treasury.gov.au/media-release/120-2017/.

202 www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Generalinsurance/Government_ _Response.

policy, as well as an assessment of the benefits and risks to making such a change (Senate Committee recommendation 4, see also ACCC draft recommendation 3 in this chapter)

- initiate an independent review of the current standard cover regime with particular regard to the efficacy of current disclosure requirements (Senate Committee recommendation 5, see also ACCC recommendation 5 in chapter 8)
- work with industry and consumer groups to develop and implement standardised definitions of key terms for general insurance (Senate Committee recommendation 6, see also ACCC recommendation 4 in chapter 8)
- review of the utility of Key Facts Sheets as a means of product disclosure, with particular regard to the effectiveness of Key Facts Sheets in improving consumer understanding of home building and contents policies (Senate Committee recommendation 7).

In its 2018 review of the General Insurance Code of Conduct, the ICA made a number of recommendations to amend the code to provide more clarity and simpler access to information for consumers about their insurance policies.[203] Proposed amendments include a new obligation for insurers to disclose the previous year's premium at renewal and a requirement for insurers, if they are unable to provide cover when an application is made, to inform the consumer of their right to ask for the information relied on. The government also urged the ICA to expedite its work on reforming the General Insurance Code of Practice.[204] We welcome the government's response.

9.2 Making it easier for consumers to understand insurance

The anecdotal feedback we heard during our public consultation is largely consistent with the findings of previous reviews and research: engaging with insurance is hard and the mandatory minimum disclosure regime is not helping consumers to understand their insurance options; not only with regard to different product features but also with regard to price. Premium pricing was repeatedly raised as an area of concern and confusion.

The ICA has previously published research showing that consumers focussed most on price (the premium) over policy detail.[205] In its submission to this inquiry, the ICA said the insurance industry needed to do more to ensure customers are not just focusing on price, but are also recognising the importance of selecting the correct product and level of coverage to suit their individual needs.[206] The Actuaries Institute made a similar point, highlighting that although the price (premium) is a key focus for consumers; the features of the policy such as the sum insured, the risks/events that are covered, the risk of damage and the excess are also important.[207]

To make a good decision on the basis of price, however, consumers must have a reasonable understanding of how each policy varies and be able to make sense of the specific terms, conditions, features, limits and exclusions that differentiate one policy from another. Most local residents and property owners who participated in our consultation concentrated on price, rather than features, inclusions and exclusions. Adjustments to excess levels and sums insured were also a focus, but as a means of lowering the overall price rather than choosing the appropriate product. This is unsurprising given the relatively high cost of insurance in northern Australia (and this is discussed further later in this chapter). Many also questioned the considerable variation in the pricing of what they thought to be comparable products from different insurance brands.

A survey of its members undertaken by Strata Community Association (Qld) to inform its submission to our inquiry found that the quality and transparency of insurance information supplied by insurers should be improved. Strata Community Association (Qld) was one of many stakeholders who called for greater

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203 Insurance Council of Australia *Review of the General Insurance Code of Practice—Final Report*, June 2018, p. 38.

204 Response is based on Minister Kelly O'Dwyer's media release on 18 December 2017—kmo.ministers.treasury.gov.au/media-release/120-2017/.

205 Insurance Council of Australia *Consumer Research on General Insurance Product Disclosures*, April 2017, p. 18.

206 ICA submission, p. 32.

207 Actuaries Institute submission, p. 8.

clarity on the factors impacting premium pricing (such as cyclone risk ratings) and noted a breakdown of insurance premiums would assist with this understanding.[208]

Consumer advocacy groups submitted that industry could, and should, do more to ensure consumers understand their own needs and the key features of a policy. They proposed various policy reforms that could improve the functioning of the insurance market. In particular, they called for greater transparency in premium pricing and better disclosure of information more generally.[209]

There are a range of education resources designed by industry and governments to help consumers understand how insurance works, common types of insurance products, how to consider risk, and tips for comparing and choosing products. These include:

- The Australian Securities and Investment Commission (ASIC) runs the MoneySmart website (www.moneysmart.gov.au), which contains extensive information for consumers about all things financial, including insurance.
- The ICA runs the Understand Insurance website (www.understandinsurance.com.au).
- Consumer advocacy group CHOICE (www.choice.com.au) provides its members with independent reviews, comparisons, information and buying guides, including on insurance (and specifically northern Australia).

We suggest there is a lack of awareness of the information available on such websites, and consider there is scope for more direct promotion to consumers. A link to MoneySmart is included on insurance Key Facts Sheets, however we recommend a link to MoneySmart on renewal notices.

Recommendation 7: A link to MoneySmart should be on new quotes and renewal notices

The Insurance Contracts Regulations should be amended to require insurers to clearly inform consumers about the Australian Government's MoneySmart website (www.moneysmart.gov.au). A link to MoneySmart using uniform text should be provided on new quotes and renewal notices.

MoneySmart includes information to help consumers understand insurance. This is an important opportunity to raise awareness of the usefulness of this website.

Should insurers provide better guidance to consumers?

Insurance providers and intermediaries are required to hold an Australian Financial Services Licence (AFSL). This allows them to sell insurance and provide financial advice. The Corporations Act, however, makes an important distinction between *general* financial advice (advice about a particular product that does not consider a consumer's personal needs); and *personal* financial advice (advice that *does* take into account a consumers' personal circumstances).

Insurers are generally qualified to offer *general* advice about insurance products only. Some call this a 'no-advice' model, as it essentially means they can only sell insurance to consumers; they cannot seek to advise or recommend a policy based on a consumer's personal situation. If consumers need help choosing or understanding their insurance they cannot normally turn to their insurer for help.

Insurance brokers, however, maintain additional qualifications which allow them to hold a different AFSL classification. This permits insurance brokers by law to provide *personal* financial advice and allows them to assist consumers to assess policy options that may suit their situation. We mention the role of brokers later in this section and more fully in chapter 10.

In 2015, the Effective Disclosure Taskforce proposed a reconsideration of how the financial advice regime applies to the general insurance industry to assist insurers to better engage with consumers. It said ASIC should provide regulatory guidance, and where necessary relief, to support the provision of advice to consumers purchasing general insurance products.[210]

208 Strata Community Association (Qld) submission, p. 3.

209 See for example, Consumer Action Law Centre submission and Financial Rights Legal Centre submission.

210 ICA Report *Too Long; Didn't Read: Enhancing General Insurance Disclosure*, October 2015, pp. 3–4.

The Financial Rights Legal Centre's submission reiterated support for the taskforce's recommendation, proposing that the current approach taken by insurers with the 'no advice' model may not allow for meaningful engagement with consumers because of the fear that assistance will cross over from general advice into providing personal financial advice. The FRLC added that while some consumers do call its Insurance Law Service for advice about the meaning of certain provisions in their insurance policies, the FRLC submitted that its resources are very limited and it can only assist a handful of these consumers.[211]

As we set out in our following discussion, estimating the sum insured is often raised as an area where insurers could, within the current regulatory settings, provide better guidance to consumers.

Recommendation 8: Better understand information that falls within 'general financial advice'

The Insurance Council of Australia should engage with ASIC to gain a clearer understanding about the nature and type of information insurers can give to consumers within the meaning of providing general financial advice.

This would ensure that insurers are not refraining from providing general information, for example about rebuilding costs and building valuations, which would assist a consumer make an informed decision about their own situation.

Choosing the type of policy and the sum insured

Insurers offer different types of policies. Our consultation suggested that some consumers may not have realised the variation in the types of policies that were available, the cost implications, and the advantages of choosing one type over another.

Box 9.1 Types of insurance policies

A **sum insured** policy will set a maximum level of cover and any payout is limited with reference to that amount. There could be limits for individual items or events. The insurer may reserve the right to decide if it will rebuild, replace or pay.

A **total or complete replacement** policy will pay all reasonable costs to repair, replace or rebuild (taking into account policy exclusions).

A **safety net** policy will pay a specified percentage above the sum insured amount. Insurers are increasingly offering a safety net policy in case a consumer under-insures.

As set out in chapter 8, the standard cover regime in the Insurance Contracts Regulations provides for total replacement cover, however sum insured policies currently dominate the market. Total replacement policies reduce the risk of underinsurance, but usually cost more. In its submission to the 2014 Productivity Commission report of *Natural Disaster Funding Arrangements*, Suncorp explained it would be concerned with any suggestion to mandate complete replacement cover policies, stating that such cover is likely to significantly increase the cost of insurance and may result in increased levels of non-insurance.[212]

Total replacement policies for home and contents insurance products are currently only offered by three of the insurers active in northern Australia. Total replacement policies make up only around six per cent of all home and contents insurance products issued nationally by these three insurers (collectively) in 2017–18. However the proportion of total replacement cover policies is much lower in northern Australia, currently around four per cent. Our analysis suggests this number has fallen in recent years, particularly since around 2013–14 when a fourth insurer who previously had a high proportion of total replacement policies began reducing this offering (and now does not offer it at all).

211 Financial Rights Legal Centre submission, p. 9.

212 Suncorp submission to Productivity Commission's *Natural Disaster Funding Arrangements—Final Report*, December 2014, p. 20.

Most claims for damage to buildings, including those arising from natural catastrophes in northern Australia, are for a partial loss and any inadequacy in the sum insured amount will not necessarily be clear. However, when a home insured under a sum insured policy becomes a 'total loss' and needs to be rebuilt, the sum insured may not be sufficient to fully replace the home. While the data we obtained from insurers suggests insurers often pay out claims up to, and even a margin over, a consumer's sum insured for home insurance, we did see some instances of clear underinsurance, where a claim pay out was only a fraction of the estimated value of the loss.

Estimating sum insured

Unlike total replacement policies, sum insured policies place responsibility for estimating the sum insured and for bearing the risk of under-estimating it on the policyholder. Following a number of reviews calling on the industry to do more to assist consumers avoid underinsurance, most insurers have taken some positive steps to help consumers by educating consumers about the risks of underinsurance and improving the availability of web-based calculators and/or incorporating them into their quotation process.[213]

While calculators can be very helpful, the variable results they produce continues to cause concern and confusion for consumers. ASIC's MoneySmart and the ICA's Understand Insurance websites explain how calculators work and things to look out for in using them, however many consumers may not find this information.

Despite near universal reliance from insurers in Australia on the Cordell calculator for building sum-insured, the results can vary considerably—our own research confirmed this. ASIC even found that some home insurance brands within the same insurer group even differed in their estimates.[214] The ICA has suggested variations can also occur because:

- the frequency of updates to data varies (quarterly/annually)
- the cost of rebuild differs from insurer to insurer based on individual arrangements with suppliers
- insurers' have their own intelligence about the cost of rebuild derived from previous claims costs in the area.[215]

We surveyed the calculators provided by leading insurers in northern Australia using the characteristics of a hypothetical property in northern Australia. These calculators asked between 17 and 47 questions and returned estimates for our hypothetical property ranging from approximately $600 000 to $665 000. It seemed to us that the range could, in part, be attributed to the inclusion or exclusion of an allowance for costs such as demolition, debris removal, and engineer/architect/legal fees. These were generally not included in the estimated sum insured if the policy provides separate cover for these costs, however this was only apparent in the disclaimers accompanying the individual calculators.

When a calculator suggested a sum insured higher than a consumer expected or variations occurred, ASIC reported that consumers had a tendency to assume the higher estimate was a deliberate sales tactic of the insurer to push up the premium, rather than an accurate reflection of current re-building costs.[216] The Effective Disclosure Taskforce made a similar finding, as did a subsequent ICA research report, which reported only 63 per cent of respondents find the home building/contents calculator trustworthy, although many consumers appear to be using them.[217]

During our consultation, consumers in northern Australia also shared their scepticism of calculators and similarly suggested that automatic indexing upwards of sum insured were both just tactics to raise premiums.[218] Insurers seem well aware of such perceptions, and yet say indexing (for example with reference to CPI or an index of construction costs) occurs as a measure to account for inflation and new purchases.[219]

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213 ASIC report 89, *Making home insurance better*, January 2007, p. 6.

214 ASIC report 415, *Review of the sale of home insurance*, October 2014, p. 58.

215 ICA Report *Too Long; Didn't Read: Enhancing General Insurance Disclosure*, October 2015, p. 36.

216 ASIC report 416, *Insuring your home: consumers' experiences buying home insurance*, October 2014, pp. 14–15.

217 ICA Report *Consumer Research on General Insurance Product Disclosures,* February 2017, p. 32.

218 See for example, Anonymous submission 51.

219 See for example, ASIC report 89, *Making home insurance better*, January 2007.

To minimise risks of consumers underinsuring, some insurers have also implemented a sum insured floor that a consumer is allowed to select. For example, Suncorp has established a 'minimum sum insured' threshold whereby a customer is unable to select a sum insured that is more than 10 to 15 per cent below the result generated by the calculator.[220] Industry also say they encourage consumers to review their sum insured every year and re-evaluate their sum insured when they renovate or make new purchases.

While the provision of accessible and increasingly sophisticated sum insured calculators is an important first step, it seems the industry could further improve consumers' use and trust in calculators and their understanding in how calculators derive particular estimations.

The Effective Disclosure Taskforce found that the development of sum insured calculators for contents has not been as advanced as that for home building insurance, and made a number of recommendations aimed at encouraging insurers to take steps to improve their calculator tools for estimating required contents coverage.[221] A survey undertaken for the ICA in 2016 found that most households (70 per cent) guess the value of their contents themselves. Almost half (45 per cent) admitted they had no idea how much their contents were worth, or thought their valuation was out by more than $5000.[222]

A survey undertaken by ASIC in 2007 found that that most insurers said that they were not in a position to provide consumers with individual advice about the adequacy of the sum insured.[223] In its 2014 report on *Consumers' experience buying home insurance*, ASIC also commented that rebuilding costs and valuing the building are two areas where insurers have information they could share with consumers as general guidelines, not necessarily personal financial advice.[224]

The Corporations Act allows insurers to provide guidance on the replacement value of home building or contents without needing to comply with the personal advice rules.[225] In its 2014 report, the *Financial Systems Inquiry* observed this, but found it was not working and insurers are not typically providing guidance on replacement value. The inquiry proposed that underinsurance and non-insurance would reduce if, as standard practice, insurers gave consumers relevant information, guidance and advice on home building and contents insurance and encouraged insurers to provide further guidance and make consumers more aware of tools that can help them to purchase adequate insurance cover.[226] We agree.

We consider that estimating the sum insured is one area where insurers could, and should, provide better guidance to consumers to lessen the risk of underinsurance. Insurers are likely to already have access to the information necessary to estimate a sum insured in relation to their customers' insured buildings. As such, they should be in a position to understand if there are material differences between the sum insured a customer has selected and the amount suggested by their own sum insured calculators.

Taking recommendation 8 (for insurers to better understand guidance they can give within the meaning of financial advice) a step further, in draft recommendation 1, we propose insurers should provide an annual estimate of sum insured for home insurance to consumers.

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220 Suncorp Home and Contents PDS 2012, p. 3.

221 ICA Report *Too Long; Didn't Read: Enhancing General Insurance Disclosure*, October 2015.

222 Insurance Council of Australia, Understand Insurance Blog, Renting? Make sure you have the right insurance, 22 June 2016, viewed 25 August 2017, understandinsurance.com.au/blog/renting-make-sure-you-have-the-right-insurance.

223 ASIC report 89, *Making home insurance better*, January 2007, p. 13.

224 ASIC report 416, *Insuring your home: Consumers' experience buying home insurance*, October 2014, p. 76.

225 *Corporations Act 2001* (Cth), s. 766B(6).

226 *Financial systems Inquiry Final Report* (2014) p. 227.

Draft recommendation 1: Insurers should estimate a sum insured for customers

The Insurance Contracts Regulations should be amended to require insurers to estimate an updated sum insured for their home insurance customers and advise them of this estimate on their renewal notice.

This estimate should note when the information used by the insurer to form the estimate was last updated by the consumer, and direct the consumer to contact the insurer if renovations/alterations to their home had occurred since then. Where the sum insured estimate is materially higher than provided for under the policy, the renewal notice should also include a warning to the customer about the dangers of their property being underinsured.

Consumers need to understand that the sum insured refers to the cost to rebuild and not the market value of their property. They also should understand that, in some cases, the sum insured may also need to cover costs involved in the repair or rebuild like debris removal, legal costs, and temporary accommodation costs. In some cases a policy may provide separate benefits for some of these items equal to a percentage of the sum insured amount. Our concerns are substantiated by the example in box 9.2 where documents we obtained from one insurer shows it knowingly had customers including land value in the sum insured.

Box 9.2 Case study: Calculating sum insured and the no advice model

In documentation obtained from one insurer, a modelling exercise it undertook did not reveal a systematic pattern of underinsurance. There was some evidence that customers insuring very high value properties had included the land value in their sum insured. However due to the no-advice model, the insurer determined it was unable to propose to consumers to consider how appropriately they had calculated their sum insured.

Recommendation 9: Disclose costs that count towards ‘sum insured’

The Insurance Contracts Regulations should be amended to require that insurers clearly disclose the types of costs that will count towards the sum insured amount for buildings (such as the costs of demolition, debris removal or for professional fees) where these are not provided for through a separate allowance under the policy. This information should be provided on any sum insured calculators used by the insurer and alongside the sum insured figure.

This will help consumers understand why and how calculator estimations can differ and empower them to make more informed decisions about their nominated sum insured. It should be provided alongside the sum insured amount for a property, including in quotes for new policies, renewals and on certificates of insurance.

We recognise the tension that exists between avoiding potential under-insurance by increasing sums insured, and the resulting impact on the affordability of insurance especially in parts of the country where premiums are already very high. Consumers are likely to prefer to under-insure their homes if it means being able to afford insurance at all. However it is critical that consumers understand the risks of such a decision.

Choosing a product

In chapter 8, we explained the concept of ‘standard cover’ and an insurer’s freedom to derogate from that and offer products with different features. Consumers need to think about the key features they want, or can afford, to include in their policy. They need to be aware of what options there are for optional coverage for certain risks such as accidental breakage or for portable contents that may be away from the insured address. In some cases, flood coverage is also optional (but may be included by default). There is significantly more variation in the coverage limitations and exclusions under these broad areas of coverage, which will be set out more fully in a PDS. A KFS will provide a summary of these features.

Insurers vary considerably in the prominence they give to these disclosure documents on their websites. In our review of insurers' websites, we found that in many cases, links to a KFS did not appear alongside their product offerings, or were located only in the 'fine print'. As discussed earlier in this chapter, the government has asked the Treasury to review the utility of KFSs, with particular regard to the effectiveness of KFSs in improving consumer understanding of home building and contents policies. We consider that any mandatory information disclosure must, at a minimum, be prominent to consumers and potential consumers.

Draft recommendation 2: Prominently publish PDSs and KFSs online with product offerings

The Insurance Contracts Regulations should be amended to require insurers to publish key facts sheets and product disclosure statements online in a prominent manner and alongside the relevant products.

They should be accessible prior to the commencement of a quoting process. This will facilitate more timely and convenient access for consumers to important information about products they are interested in buying.

Consumers can also usually nominate an excess that suits them. The higher the excess the consumer is willing to pay in the event of a claim, the lower they pay upfront for the premium. As discussed in chapter 3, we found that raising the excess for home and contents products from a median of $1500 to $5000 could lower premiums by between 15 and 19 per cent. Conversely, lowering the excess from a median of $1500 to $500 increased premiums by 15 to 16 per cent.

These choices, in particular for flood coverage, can have a significant impact on premiums. However the magnitude of these impacts is not transparent for consumers. While some insurers provide a breakdown of the components of their premiums, this is not always the case. In order to enable new and renewing customers to make an informed decision about which product features, excess levels and sums insured to select, the price impacts of these decisions should be clearly stated, as we propose in draft recommendation 3. This could be as a percentage surcharge or discount, or a specific dollar amount. In relation to the sum insured, this would be with reference to the price effect of selecting an incremental increase, or decrease, in the sum insured amount (for example, of $25 000 for a building policy).

Draft recommendation 3: Disclose premium impacts of optional inclusions or exclusions

The Insurance Contracts Regulations should be amended to require that insurers disclose the premium costs or saving for each optional inclusion or exclusion they offer to a consumer. Insurers should also indicate the premium cost or saving associated with incremental changes in excess levels and sums insured. This information should be provided to a consumer with a quote for a policy and upon its renewal.

Providing consumers with information about the cost impact of optional inclusions/exclusions (e.g. flood cover, accidental breakage cover) as well as variable costs (such as changing an excess or sums insured) will allow consumers to make more informed decisions about their choice of cover.

Can comparison websites help?

Websites that compare products on price and/or features have become popular across many industries over the past decade including in energy, telecommunications, financial services and health insurance.

Comparison websites (generally) can help consumers to:

- minimise their search time by visiting just one website to see a wider range of choice
- more easily compare products that are often quite complex or involve a long-term or significant financial commitment
- find products or services that best match their preferences by allowing them to filter or search by features and/or price.

By facilitating more informed consumer decision making, comparison websites can also support competition between suppliers and put downward pressure on prices. They can also provide an opportunity for new entrants to increase consumer awareness of their brand at relatively low cost, reducing a barrier to entry.

A number of commercial websites are currently operating in Australian markets for home and/or contents insurance (such as iselect, Choosi, and Compare the Market). In 2015, the Australian Government launched its own independent website specifically for north Queensland. The North Queensland Home Insurance (NQHI) website, run by ASIC, followed Treasury's 2014 consultation on options to address the high costs of home and strata title insurance in north Queensland. The consultation recognised that strata insurance is more complex and not well-suited to a comparison website.[227]

While comparison websites generally can support consumer-decision making, they are not a complete source of information and still require consumers to consider how relevant the results are compared to their own needs and preferences. Commercial websites attract a range of additional concerns such as not comparing product offerings from all providers in a market, conflicts that can arise when some sites are owned by the providers they are comparing, and the revenue streams that fund the provision of the website. We consider some of these issues of conflict and disclosure in chapter 10.

Australia's four largest insurers do not participate in commercial insurance comparator websites, meaning consumers who use these sites do not see insurance products offered by those insurers. Suncorp has previously explained it does not participate due to its concerns with the operation of the sites and the accuracy of the information being presented to consumers.[228] Similarly, Allianz advised that it does not participate as commercial websites charge a fee for service and therefore impose an additional cost that would need to be passed on to customers.[229]

In 2017, the Senate Committee considered the costs and benefits of establishing an independent home, strata and car insurance comparison service to apply more nationally and recommended the government should complete a detailed proposal for a home and car comparison tool.[230] The government responded that there are already a number of commercial websites and there is no clear evidence of market failure in either the insurance industry or comparison website market to suggest that government intervention is warranted. The government did, however, note the Committee's related recommendation for ASIC to undertake a review of the NQHI, saying ASIC should consider a review once the final report of the ACCC's inquiry is released.[231]

Our consultation invited comments from consumers about examples of tools, technology or information in other industries that could be used to make insurance easier to understand. A number of consumers

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227 Australian Government Treasury discussion paper, *Addressing the high cost of home and strata title insurance in North Queensland*, May 2014.

228 Suncorp submission to the *Senate inquiry into Australia's general insurance industry*, p. 12.

229 Allianz submission to the *Senate inquiry into Australia's general insurance industry,* p. 2.

230 Senate Economic Reference Committee, *Australia's general insurance industry: sapping consumers of the will to compare*, August 2017, p. 43.

231 Australia Government response to *Senate inquiry into Australia's general insurance industry December 2017*—static.treasury.gov.au/uploads/sites/1/2017/12/p2017-t248756.pdf.

said it would be good to have one impartial website where consumers could go to compare prices and policies, and all insurers should be required to participate.[232] Several of these consumers mentioned the Australian Government's private health insurance comparison website as a starting point.[233]

Our consultation did not reveal a high level of awareness of the NQHI website among north Queensland locals, suggesting there may be scope for a renewed awareness effort.[234] Of the consumers who had used either the NQHI or a commercial website, some agreed it was helpful for research but others reported the comparison websites they had tried advised there were no policies available to them in their area. Some consumers also commented that comparison sites were not useful as they don't include all insurers, don't show the components of premiums and they don't represent an individual's needs.

Insurers maintain scepticism about the value of a geographically broader (independent) home and contents insurance comparison website. Allianz has submitted that it would likely exacerbate premiums in high risk areas and reduce competition (it did not provide a reason for this in its submission to our inquiry),[235] while Suncorp noted that price will become the key determining feature, which is likely to have a negative impact on the industry by stifling the development of innovative product features and business models.[236] IAG similarly submitted that a comparison service would only emphasise price rather than educate consumers on the insurance they require.[237]

Other stakeholders, such as Actuaries Institute and Consumer Action Law Centre, remain open to the possibility of a national independent website, but caution that if one is to be established, it must be able to accommodate comparing policies appropriately and not focus consumers just on price but rather to consider risks, needs and preferences.[238]

Measures undertaken to improve the comparability of insurance products across the market, especially on nonprice factors, would likely make it easier for insurance comparison websites to provide consumers with a more useful and comprehensive view of product variations across markets.

We acknowledge concerns that insurance comparisons websites may have the potential to over-simplify the decision and lead consumers to focus their attention on price, rather than important differences in policy cover and terms and conditions.[239] However we consider that these concerns can likely be managed through thoughtful website design.

In draft recommendation 4, we propose the government give further consideration to a new national home insurance comparison website. To be optimally effective, we consider such a website must:

- require the participation of all insurers active in relevant markets to participate
- be visible. That is, consumers need to be aware that it exists and there is a benefit to using it
- be capable of providing information and allowing consumers to compare policies by features, not just by price. Implementation of standard definition of key terms, a product based on standard

232 See for example, submissions from Anon 126, Anon 46, P. Kelly, and M. Gray.

233 The Australian Government's website, PrivateHealth.gov.au is managed by the office of the Private Health Insurance Ombudsman.

234 In its submission to the *Senate inquiry into Australia's general insurance industry*, ASIC reported the NQHI website had 13,356 sessions for the period 31 March 2015 to 31 December 2016.

235 In its submission to the *Senate inquiry into Australia's general insurance industry*, August 2017, Allianz explained that its experience with insurance comparison sites shows that it biases consumer purchasing behaviour towards an unhealthy focus on price over the qualitative features of insurance products. Customers faced with a range of prices for insurance cover offered by a number of well known, established and trusted brands, tend to gravitate to the lowest price. Even if the lowest priced insurer has best practice pricing capability and does not believe it has mis-priced the risk, it then suffers a different type of insurance risk. That is, accumulation risk, or the risk of accumulating an excessive share of customers with a particular risk profile, which may exceed the insurer's risk appetite for customers with that risk profile.

236 Allianz submission, p. 1; Suncorp submission, p. 26.

237 IAG submission, p. 28.

238 Actuaries Institute submission, p. 8; CALC submission to *Senate inquiry into Australia's General Insurance Industry*, August 2017, p. 3.

239 See for example, Allianz submission to the *Senate inquiry into Australia's general insurance industry,* p. 1.

cover and more transparent pricing of premium components, as we have also recommended, would facilitate more simple and meaningful comparisons

- make it very easy for consumers to act on the results of their research in timely and convenient way. This could, for example, be achieved through a 'live' quote comparison feature, which allows consumers to proceed directly to the insurer's website to purchase based on information they have already provided.

Draft recommendation 4: National home insurance comparison website

The government should consider developing a national home insurance comparison website. It should require the participation of all insurers active in relevant markets, allow consumers to compare policies by features, and make it quick and easy for consumers to act on the results.

An independent insurance comparison website may facilitate more informed consumer choice by assisting consumers to quickly and easily find insurers in their area and offering policies that meet their needs. Comparison websites can provide an opportunity for new entrants to increase consumer awareness of their brand at relatively low cost, reducing a barrier to entry. Enhanced comparability of products, such as through standardised definitions (recommendation 4) and mandated standard cover (recommendation 5), will assist in the effectiveness of such a website.

The role of insurance brokers

While the use of insurance brokers is very common for strata insurance, individual property owners typically engage brokers less often as home and contents insurance products are less customised, more readily available and premiums relatively lower.

However in northern Australia, our consultation with local residents and property owners suggested a higher than usual awareness of the role of brokers. It seemed to us that increasing prices and/or a perceived lessening of choice has forced many consumers to be relatively well engaged with their insurance and how brokers can assist.

Some individuals reported success using brokers to obtain insurance in an otherwise difficult-to-insure area or postcode. Others provided us with examples of their broker's efforts to obtain a range of quotes for them, but which still showed that some or most of the insurers approached declined to provide a quote. Others were not convinced that brokers were helpful, suggesting they were more expensive and used preferred insurers that would give them the highest incentive. In its submission to the inquiry, Legal Aid Queensland suggested that in its experience, that many consumers are unaware of brokers, or do not view them—rightly or wrongly—as adding any value.[240]

Box 9.3 Extracts from submissions from local residents and property owners

'Brokers are generally just selling the products that get them highest commission—(they) don't really fully understand the complex challenges and risks of northern Australia and the policy fine print.'[241]

'We tried a broker. Most appear to be subsidiary to insurance companies. The rest were locked in by available companies.'[242]

'We use a broker all the time. It's the only way to get cover most insurance companies won't deal with us unless through a broker.'[243]

As mentioned previously, brokers are able to provide personal financial advice to consumers. They are required to act in the best interests of the consumer in arranging insurance, but typically obtain a commission from the insurer for selling a policy. The role of intermediaries, including broker arrangements, commissions and potential for conflicts are discussed in detail in chapter 10.

240 Submission from Legal Aid Queensland, p. 9.

241 Submission from Anonymous 142.

242 Submission from Anonymous 13.

243 Submission from Anonymous 122.

9.3 Responding to the pressure of price: negotiating, switching and underinsuring

Participants in our public forums spoke of insurance premiums rising substantially, pushing them into real financial distress. Some said they couldn't afford to stay in their town, but they couldn't afford to go. They explained the financial burden of high insurance cost is exacerbated by significant falls in the value of their properties, a point that was particularly stressed at the forums we held in Karratha and Broome. People told us they wanted to have options such as insuring their properties at market value or even insuring just against the amount owed on a mortgage, but said insurers required them to insure at replacement values. They spoke of governments wanting people to live and work in regional Australia, but that the cost of living there was becoming prohibitive.

As we reported in our discussion in chapter 3, there are many areas in northern Australia facing an average annual home and contents premium above $4000. In its submission, Allianz said the cost of home insurance could be equivalent to the annual income of a person on the aged pension that might own such a property.[244]

At such extreme levels, insurance premiums start to drive other behaviours and decisions that carry a range of negative consequences. For example deliberate underinsurance, purchasing of cheaper policies that do not meet a households' needs, non-insurance, a shift away from investment in residential property, and discouraging population growth in whole regions.

Box 9.4 Extracts from submission from local residents and property owners

'As I am not allowed to rent my property without taking out home insurance I have no choice but to pay an excessive premium and to try and keep the costs down I have opted for a massive excess. In other words the only insurance claim I will ever make in the near future will be for something major or total destruction of my house. My insurance premium will no longer be valid for 'normal' everyday claims like a broken window, broken water pipe that damages a bathroom vanity or a fallen tree damaging my roof.'[245]

'Now that we have retired and our income is fixed, the only option left open to us is to get rid of house insurance all together.'[246]

'To manage the cost of insurance we have put extremely high excesses on everything and now we can hardly claim anything. If a window is accidently broken, we have to pay for it. If something fuses, we have pay for it. We now wonder is it worth having insurance or should we just put the money in the Bank.'[247]

Consumers should be given more time to shop around and pay their premiums

A renewal notice advising of a premium increase, and/or a consumer's preference for a policy with different features, could motivate a consumer to consider switching.

The Insurance Contracts Act requires the insurer to provide written notice no less than 14 days before a contract of general insurance is due to expire and indicate whether the insurer is prepared to negotiate to renew or extend the cover.[248] We do not consider that 14 days' notice of a renewal quote gives consumers appropriate opportunity to explore their options and shop around. It also may not give some consumers sufficient time to have funds available to pay their renewal, particularly if a renewal is higher than a consumer has budgeted for.

244 Allianz submission, p. 15.
245 Submission from T. Scott.
246 Submission from Anonymous 141.
247 Submission from Anonymous 99.
248 Insurance Contracts Act, s. 58(2).

We consider that all insurers be required to give no less than 28 days of notice, with a reminder sent no less seven days before expiry. We acknowledge some insurers, as a matter of good practice, already provide 28 days' notice or longer.

Draft recommendation 5: Renewal notices should give 28 days notice

The Insurance Contracts Act should be amended to require insurers to provide renewal notices for home, contents and strata insurance no less than 28 days before the expiration of their insurance coverage.

The Insurance Contracts Act currently requires no less than 14 days. The current minimum timeframe does not provide consumers with sufficient time to consider their renewal quote and explore their insurance options. It also may not be sufficient time for some consumers to have ready-access to funds.

During our public consultation, we heard consumers say that as a result of monthly payments and/or negotiated discounts after receiving an invoice, they sometimes were not aware of the final amount of the premium they had actually paid.[249] The government agreed with the recommendation of the Senate Committee to require insurers to disclose the previous year's premium on insurance renewal notices and has asked the Treasury to assess this proposal.[250] We generally support this requirement, however our recommendation goes a step further and would require insurers to also disclose the excess and sum insured of the expiring policy. The premium should always be considered alongside these two important factors.

Recommendation 10: Disclose the premium, sum insured and excess on a renewal notice

The Insurance Contracts Regulations should be amended to require that renewal notices for home, contents and strata insurance clearly disclose the premium, the sum insured and any excess of the expiring policy. Insurers should also provide this information upon request.

This will allow consumers to easily identify how the insurer proposes to vary these terms from the previous year and seek explanation of any changes.

Negotiating for a lower premium

Triggered by premium increases, many local residents and property owners told us they contacted their existing insurer in an attempt to negotiate their premium. While this was often helpful, it only helped so much. Of the towns where we held public forums, participants' anxiety was particularly evident in Broome and Karratha, where residents spoke of receiving renewal notices in the order of $9000 to $12 000 per year—and sometimes even higher. Many of these residents stated they achieved substantial reductions by directly negotiating with the insurer and challenging their insurer's assessment of the risk of their property. Sometimes they rang multiple times, each time negotiating an incremental discount.

While consumers welcomed any reductions they could negotiate, we had a sense that consumers' success, in some instances, served also to compound their disillusionment with insurers and the degree to which they trusted the setting of the premium. If a reduction of several hundred dollars to even over $1000 could be achieved by haggling, they wondered why it was necessary to price it so high without explanation to begin with.

Switching to another insurer

Suncorp submitted that the ability for consumers to easily switch insurer is greater than in any other market in the financial services sector. It said this is due to most products having a 12-month term,

249 See for example, Broome public forum summary p. 2.

250 Australia Government response to *Senate inquiry into Australia's general insurance industry*—static.treasury.gov.au/uploads/sites/1/2017/12/p2017-t248756.pdf.

giving consumers a reminder and a prompt to consider other products that may exist that best suit their needs and circumstances.[251] IAG similarly submitted about the ease of switching:

> It is relatively quick and easy to switch insurance providers. Nearly all insurers provide customers with the ability to get a quote and buy an insurance policy online. Switching only takes a few minutes and does not require income, bank or property statements. In comparison to other financial products like credit, personal loans or mortgages where evidence and pre-approval is required; we believe that there are low barriers to switching between general insurance providers.[252]

Switching fundamentally relies on consumers having a choice between a range of insurers offering competing products. However, the limited availability of insurance in many parts of northern Australia is, at best, offering consumers limited options to compare, and in some cases, no options. While it may be easy for some consumers to switch, the consensus from our public consultation was that it is not so easy.

We heard the frustration of consumers who went to all the effort of filling in online forms or providing all the required information, only to be told that an insurer would not provide a quote for their property. That comparison websites did not return products for some postcodes. That products offered by other insurers were significantly over-priced. That researching and comparing is so time consuming and so much effort. For some consumers, the lure of a new discount attracted them to switching, but for others losing an existing discount (such as a loyalty or multi-policy discount) was perceived as a barrier. Our analysis in chapter 7 showed that around 27 per cent of discounts received by customer are for multipolicy discounts, and around 12 per cent for staying with an insurer for multiple years. The most frequent discount consumers received is for a no-claim bonus, which can often be transferred to or recognised by another insurer.

As illustrated by the examples in box 9.5, many local residents and property owners across northern Australia conveyed a sense of cynicism towards trying to investigate alternate policies.

Box 9.5 Extracts from submissions from local residents and property owners

'It is alot of effort as you have to compare 'apples' with 'apples' and it involves alot of reading which is very confusing and most times you feel like you require a legal representative to help you understand the terms and conditions.'[253]

'I used to ring around every year, this year I have rung some and used websites to get quotes. I generally have to put aside a whole day to ring around and sit on the computer to get thru 10–15 insurers, generally frustrated tired and confused by the end of the day. I am not totally computer savvy either.'[254]

'It's time consuming & sometimes a waste of time looking for new house & contents insurance because it's pointless if certain companies won't insure North Queenslanders.'[255]

'I looked up on the websites of a number of insurers. Its a lot of work to put in all the details and in the end being declined all together because of where you live or getting a quote for a ridiculous price.'[256]

Of the local residents and property owners across northern Australia who responded to our online consultation, many indicated they had switched, or were thinking about switching:

- Over half of the consumers who responded indicated that they had switched policies. Most of these consumers switched policies for a better premium. Many commented that it was very time

251 Suncorp submission, p. 29.

252 IAG submission, p. 26.

253 See submission from Anonymous 99.

254 See submission from Anonymous 25.

255 See submission from Anonymous 46.

256 See submission from Anonymous 76.

consuming and a lot of effort. Others commented that it was difficult to compare policies and understand definitions.

- Of those consumers that had switched policies, several indicated that they switch regularly, many yearly.
- Around one quarter of consumers indicated that they had considered switching but could not find better offers, had limited or no other options.

Insurance brokers provided similar views, particularly in relation to strata insurance. NIBA submitted that switching insurers is a matter considered by insurance brokers every day and almost always, there is no alternative cover available.[257] The Council of Queensland Insurance Brokers submitted, 'Market capacity is limited. There have been incidences in the past when our members were dissatisfied with an insurer and wanted to move their portfolio only to find that most insurers were close to capacity and unable to accept a large portfolio of business.'[258]

The Strata Community Association (Qld) surveyed its members to inform its submission to our inquiry. 75 per cent of the members who responded to the Strata Community Association (Qld) survey indicated that their clients had very limited choice, while the remaining 25 per cent indicated choice was limited. 87 per cent of the respondents said that they had experienced an inability to obtain insurance for one of their clients.[259]

In relation to strata, other than the lack of policies available, concern has been expressed about body corporate managers arranging and managing insurance when they may have little or no training in or understanding of insurance issues, impacting on the occurrence or appropriateness of switching.

According to data we obtained from insurers, the average retention rate across insurers in northern Australia in 2017–18 was around 84 per cent, which indicates around 16 per cent of consumers either let their insurance lapse or switched to a new insurer. The rates of retention are broadly consistent between northern Australia and the rest of Australia. We did not observe significant correlation between average premiums and lapse rates. Our findings about the nature of competition and choice for consumers in northern Australia are discussed in detail in chapter 7.

Increasing excess to reduce premium

Many consumers who participated in our public consultation discussed that they had, often multiple times, increased their excess to reduce their premium. While increasing their excess had made their premium more affordable, the price impact was not usually enough to mitigate their concerns about cost altogether. In fact some feared they had, or would eventually, need to raise their excess so high that they may not be able to afford to pay it if they did need to make a claim.

257 NIBA submission, p. 9.

258 Council of QLD Insurance Brokers submission, p. 2.

259 Strata Community Association (Qld) submission, pp. 2–3.

Box 9.6 Extracts from submissions from local residents and property owners

'I am down to just insuring building with a huge excess just trying to make it affordable and have some cover.'[260]

'We have not yet had to claim for any event..we are insured for replacement value but have increased our excess to reduce the premium.'[261]

'To manage to cost of insurance we have put extremely high excesses on everything and now we can hardly claim anything. If a window is accidently broken, we have to pay for it. If something fuses, we have pay for it. We now wonder is it worth having insurance or should we just put the money in the Bank.'[262]

Chapter 3 sets out a detailed analysis of trends in premium prices, including excess levels selected by customers in northern Australia. Our analysis confirmed that average excess levels in northern Australia are generally higher than the rest of Australia. Our data also shows that there has been a greater increase in average excesses across north Queensland and north Western Australia compared to the rest of Australia.

In contrast to our analysis in Chapter 3 the ICA suggested that more consumers in the north generally select *lower* excess payments compared to policyholders in the south. The ICA says choosing a lower excess facilitates consumers lodging more frequent claims (because the excess is not such a deterrent), but leaves consumers paying higher premiums.[263]. Suncorp similarly suggested that there is no trend toward high excesses in high risk locations, with 92.5 per cent of north Queensland policyholders choose an excess of $1000 or less, compared to 93 per cent across Queensland. Suncorp's submission said that minor claims represented 86 per cent of claims filed, and 29 per cent of the total claims cost. It said most consumers want to have the comfort of knowing they are covered, even for small damage caused by weather events.[264]

As we identified in focus area 2 (see chapter 3), we will undertake a number of detailed case studies on parts of northern Australia throughout 2019. This will include consideration of excess and claims levels.

Decreasing sum insured and/or coverage to reduce premium

Although only a small proportion of consumers who participated in our online consultation responded that they would not reduce their level of coverage and are not prepared to underinsure, many consumers who participated in our public consultation discussed decreasing their sum insured and/or their coverage in an attempting to reduce their insurance premiums.

260 Submission from Anonymous 33.
261 Submission from N. Tillett.
262 Submission from Anonymous 99.
263 ICA submission, p. 28.
264 Suncorp submission, p. 27.

Box 9.7 Extracts from submissions from local residents and property owners

'I have maintained adequate cover for my building and contents but I have significantly reduced the extra 'frills' to make it more affordable. I now treat it as 'disaster insurance'.. I have had to remove broken glass, motor burnout, food spoilage, contents away from home and other extras and increase my excess to reduce my premiums to a more affordable amount.'[265]

'Our insurance is basically a piece of paper offering us little as we can't afford the policy that would be best suited for the property.'[266]

'We insure to the minimum requirements, and also exclude flood cover due to our hillside location.' [267]

One of the causes of underinsurance includes consumers setting their replacement value amounts too low. This can be due to a lack of knowledge and the specialist skills required to more accurately estimate the cost of rebuilding a home and replacing home contents, but it could also be part of a consumer's deliberate effort to reduce an insurance premium. Consumers are generally able to adjust their sum insured, however we understand some insurers won't allow a reduction below certain amounts as a way of ensuring consumers are not underinsured.

The Productivity Commission found that many customers underestimate, or are sceptical about, the risks they are exposed to. The same report also found that while flood cover has increased significantly, some stakeholders had raised concerns that the introduction of flood insurance may be leading to underinsurance, as some households are opting out of insurance altogether to avoid paying large premiums.[268]

The inclusion and exclusion of flood cover was also as a key theme of our public consultation. We received mixed feedback, with some people concerned that they wanted flood cover and either didn't think they could get it or couldn't afford it, and others who didn't want it and were forced to pay to include it.

In early 2014, Choice examined 64 household building and contents insurance policies across 29 insurance brands nationally. Only four insurers excluded flood cover from their policies, and a further three allowed customers to opt out. [269] Of the major insurers currently supplying insurance in northern Australia, some offer flood cover as optional (including Allianz) and for others it is mandatory (including Suncorp, CGU, QBE and RACQ).[270]

The Financial Rights Legal Centre submitted that, in its experience with operating the Insurance Law Service phone line, consumers are generally happy about signing up with a cheaper insurer, with a product with less coverage until they have a claim rejected.[271]

Owners of strata properties were particularly fearful of rising premiums discussing they were bound by law to insure their buildings and were running out of options (see some examples in box 9.8). Some said they knew of instances where strata properties had been without insurance because they simply could not find an offer of cover, regardless of cost. Submissions from strata representative groups reiterated these concerns.

265 Submission from Anonymous 143.

266 Submission from A. Briginshaw.

267 Submission from N. Tillett.

268 Productivity Commission *Natural Disaster Funding Arrangements—Final Report*, December 2014, p. 449.

269 As cited in Productivity Commission *Natural Disaster Funding Arrangements—Final Report*, December 2014, p. 450.

270 Based on publicly available information in insurers' PDSs.

271 Financial Rights Legal Centre submission, p. 6.

Box 9.8 Extracts from submissions from strata property owners

'Price is always important. We own a Management Rights business in a Strata Title complex with our main business Holiday Letting. Insurance is compulsory for us and the legislation we operate within (BCCM Act) stipulates that the buildings and common property must be insured at Full replacement cost. This means the Body Corporate (BC) must insure the property for reinstatement of the property to its condition as new even if the property is 30 years old. Not to its condition as it was just before the insurance claim. To determine the replacement cost we must have a formal Valuation of the property every 5 years.'[272]

'I own several properties in the Northwest and the issue is that current WA laws require strata titled properties to be well OVERINSURED.'[273]

'Re: reduce our level of coverage. Strata legislation forbids us to do so, so we can't. Those not in strata properties are reducing their coverage.'[274]

9.4 Non-insurance and innovations to support more accessible insurance

During our public consultation, local residents and property owners across northern Australia emphasised their grave concerns about the affordability of insurance. We have documented those concerns already throughout this report and included some typical comments we received in box 9.9. We heard more than a few instances of people across northern Australia making a deliberate decision to not renew their policies, usually as last resort. It was not clear how many of these people were doing so (knowingly or unknowingly) in breach of a mortgage condition to hold current building insurance.

Box 9.9 Extracts from submissions from local residents and property owners

'We are now teetering on the point of having to forgo insurance completely due to the huge increases every year. We do the rounds of insurance companies every year trying to get the best price, but some will not even quote now because of the location.'[275]

'[Insurer A] told us they could no longer insure us (something to do with their underwriters). We then checked as many insurance companies as we could and the only two that would insure us were [Insurer B brand 1] and [Insurer B brand 2] but their premium was around $6000 pa. We then decided to risk being uninsured as we could not afford that as we are pensioners. This was a very difficult solution but the only one we could make.'[276]

'I'm not insuring anything and putting the money I would have spent into a savings account.'[277]

As noted in chapter 1, charities and governments in Australia provide significant amounts of assistance to households and communities who have been adversely affected by natural disasters.[278] High rates of private insurance are socially beneficial, not only in terms of the efficiencies of risk pooling, but also in reducing the reliance on governments (taxpayers) and charities to support the personal hardship that arises when uninsured property is damaged or lost in disaster situations. As the 2011 report of the *Natural Disaster Insurance Review* (NDIR) pointed out, while this assistance provides much needed relief necessary in reconstruction and recovery, it can risk being seen as a premium-free insurance against natural disasters, discouraging private insurance.

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272 Submission from K. Beck.

273 Submission from D. Warburg.

274 Submission from M. Shaw.

275 Submission from Anonymous 141.

276 Submission from P. Crewe.

277 Submission from S. Clayton.

278 *National Disaster Insurance Review—Final Report*, November 2011, p. 83.

Good Shepherd Microfinance has previously identified four fundamental barriers to consumers entering (or staying) in the insurance market:

1. Affordability: where the price point excludes people on low incomes from participating
2. Accessibility: where other product features, such as payment frequency and method, excludes people from participating
3. Understanding: where a lack of financial literacy, and therefore a lack of understanding of insurance and the contribution that insurance makes to personal financial resilience—excludes people on low incomes from participating
4. Trust: where a lack of trust of insurers ('they won't pay out'; 'they won't insure me'; 'did you hear about this claim where..') results in people choosing not to participate.[279]

We are not aware of any current study exploring the rates of under or non-insurance in northern Australia specifically. In its interim report, the NAIP Taskforce referenced the ICA as saying there does not seem strong support for the idea that insurance premiums are causing a greater number of people in northern Australia to non-insure compared to the southern regions.[280] However this observation was not repeated in the final report and our own preliminary analysis of the rates of non-insurance in northern Australia give us reason for concern. We have identified this as a focus area for 2019 (see focus area 3).

Data on the rates of non-insurance and underinsurance nationally is also limited, however the Productivity Commission suggests that the rate of noninsurance of homes in Australia is relatively low.[281] According to a 2007 report prepared for the ICA, policyholders are generally tolerant of some increases in their home insurance premiums and will absorb premium increases rather than let their insurance lapse.[282] Letting home insurance lapse would be seen as undesirable: the home is often the primary financial asset and homeowners highly value the protection offered by insurance. Also, for those who have mortgages, the lenders typically require the owners to maintain their home insurance.

However, if faced with continued large increases in home insurance premiums there will be a point at which more property owners will begin to consider not renewing their insurance policies. This is an important topic and one that we will investigate further as our inquiry progresses.

Focus area 5: Understanding non-insurance and how it may be addressed

We will explore the extent and reasons for non-insurance throughout northern Australia, including in indigenous communities. As part of this focus area, we will consider current and potential measures to improve the accessibility of insurance to low income households. We will look at the extent to which insurers make Centrepay available to eligible customers and why hardship policies are generally limited to the payment of an excess and not a premium.

This will help us provide a more complete assessment of the accessibility and performance of insurance markets in northern Australia and help guide any other policy responses. Insurance is a 'near essential' product. There are currently very limited obligations on insurers to improve its accessibility to all members of the community and evidence of innovation is lagging other industries. Industry hardship programs are less sophisticated and more limited in accessibility than other industries.

Innovations to support more accessible and affordable insurance

The total premium is only one part of an affordability problem. The other dimension is the policyholder's ability to make the payments at the time they fall due. The report of the NDIR agreed there is scope to improve low income earners' access to insurance products through addressing the cash flow issues that

279 Good shepherd Microfinance submission to *Senate inquiry into Australia's general insurance industry,* p. 3.

280 *Northern Australia Insurance Premiums Taskforce Interim Report,* 2015, p. 17.

281 Productivity Commission *Natural Disaster Funding Arrangements—Final Report*, December 2014, p. 447.

282 Dr Richard Tooth and Dr George Barker, *The Non-Insured: Who, Why and Trends*—report for Insurance Council of Australia (ICA), May 2007, p. 12.

can limit their ability to make 'lumpy' payments, and we suggest this generally applies to many average income households facing premiums exceeding several thousand dollars.

Insurance premiums have traditionally been paid in an annual lump sum, however insurers are increasingly offering consumers the option of paying in regular instalments. While some insurers offer this flexibility for no additional cost, others charge either a flat fee of up to $78 per annum, or a surcharge of up to 20 per cent of the premium. While we generally welcome bill smoothing, a monthly loading of 20 per cent does not suggest this payment option is offered as a measure to make insurance more accessible. Consumers need to factor in whether the value they achieve from payment smoothing is greater than what it costs them in additional payments over the year.

Centrelink commenced offering the payment of home and contents insurance premiums through its Centrepay payment facilities in 2011.[283] Centrepay is widely available to eligible consumers of other important household goods and services, such as energy, water and telecommunications. However it is not widely offered by insurers. Data we obtained from insurers indicates there are only 10 eligible customers using Centrepay in northern Australia. These are all customers of the same insurer. As part of our further exploration of measures to improve the accessibility of insurance to low-income households (see focus area 5), we will be looking closely at the availability of Centrepay and ensuring it is more widely available.

Industry has previously explained there are a number of difficulties in accepting fortnightly payments through Centrepay, such as transaction fees, the risk of cancelling a policy if a person's Centrelink payments are suspended, and the incompatibility of many insurers' systems with receiving fortnightly payments, which are generally built to accept monthly or annual remittances.[284]

In spite of the profit motivations of commercial insurers in Australia, we are aware of some insurance products designed to create more affordable insurance policies:

- *Essentials by AAI* (developed by Suncorp in conjunction with Good Shepherd Microfinance) is available to people with a Health Care Card, receiving Centrelink payments or with household income under $48 000.[285] Suncorp indicated in its submissions that nearly 1000 (annual) Essentials by AAI policies have been rolled out nationally since it commenced in 2015.[286]
- *Insurance 4* (developed by IAG in conjunction with Good Shepherd Microfinance) that allows policyholders to insure selected items, including computers, appliances and furniture. The initiative, launched in 2015, is aimed at individuals who are less likely to insure including students, young professionals, first-time renters, retirees, pensioners and the budget-conscious.
- *Small Strata* (developed by Suncorp in 2015) provides cover for small residential strata properties, community titled properties or residential properties associated with a body corporate or owner's corporation (up to 10 units or $5 million sum insured). As smaller strata properties carry a simpler risk profile, the product can be sold directly from Suncorp call centres and online without intermediary services. Suncorp indicated the direct channels make the product approximately 20 per cent cheaper than competitors.[287]
- *InsureLite* (developed by IAG) was a trial product launched in 2015 and recently discontinued. It offered home insurance for damage caused by significant events and only when a minimum damage threshold is reached. In the event of a total loss, the policy provided a new home up to the value pre-selected by the customer of either $150 000 or $200 000 or a cash payment up to the same amount. IAG says it will take learnings from InsureLite into future product development and propositions.[288]

283 Centrepay is available as a payment method to recipients of Centrelink payment for a range of typical household expenditure, particularly utilities. It usefully matches a consumer's receipt of income with regular payments to determined providers.

284 Good Shepherd Microfinance Discussion Paper *Insurance for low-income Australians: Taking Innovative Action,* March 2013, p. 18.

285 See www.essentialsbyaai.com.au/.

286 Suncorp submission, p. 37.

287 Ibid.

288 See InsureLite website: www.insurelite.com.au/#/index.

We encourage industry to continue to develop insurance products and practices to assist low income and other vulnerable consumers. We will explore accessible insurance further as part of focus area 5.

9.5 Access to data in insurance

More granular data, and increasingly sophisticated analysis of that data, is allowing insurers, and also consumers, to identify and understand risks more clearly. This offers significant benefits to the community through improved risk identification, product innovation, and mitigation opportunities, but it also raises new concerns with issues of risk segmentation, access, sharing, and privacy.

Understanding risk

To make good decisions about insurance, consumers need to have an understanding of their risk profile and the likelihood of their property experiencing damage. Participants in our public consultation repeatedly raised concern that insurers were simply determining their premium by their postcode, not by the individual characteristics and risk of their property. They called for better access to the information that insurers relied on to make assessments about risk.

Box 9.10 Extract of submission from a local resident

'I have tried to insure my house with [Insurer]. However they tell me they can't insure my house due to flood mapping. I asked where they get their flood mapping advice as my house has never been in a flood zone. They gave me their 3 sources they used. I contacted all 3 sources and my house was not on either of them. I then queried this again with [Insurer]. They told me they 'put a buffer zone on the flood zone'. I then put in a complaint about this. They then decided they would insure me but quoted me a ridiculous price of thousands of dollars basically obviously to get rid of me. ...'[289]

Consumer groups also consistently submitted that consumers should be aware of what factors influence insurers' risk assessments and pricing to ensure they are provided an opportunity to properly inform an insurer of their circumstances. Legal Aid Queensland agreed that community insurance education programs are necessary to support and complement risk awareness and risk reduction. A key part of these programs is to help consumers understand that price reflects risk.[290]

According to Financial Rights Legal Centre, insurers have become much better at clearly disclosing to consumers that they can opt out of flood cover, and warning people at renewal time that they have opted out. The FRLC submits this has improved since the 2011 *National Disaster Insurance Review*, however, they still come across consumers that may have understood that they opted out of 'flood cover' but did not understand the definition of 'flood' or did not understand the risk of flood on their property.[291]

Consumers should also be aware of what factors influence their risk assessment and pricing to ensure they are provided an opportunity to properly inform an insurer of their circumstances. By having information relevant to pricing assessment, consumers will:

- have the opportunity to explore mitigation measures to lower their risk and premiums (see chapter 12 on mitigation)
- be able to compare risk assessments and pricing decisions of different insurers. [292]

The industry is putting in place a number of initiatives in place to help with consumers' understanding of their risks generally. For example IAG has developed the NRMA Safer Homes resource to assist people to understand their own risk profile, mitigation options and insurance needs.[293]

289 Submission from Anonymous 1.

290 Submission from Legal Aid Queensland, p. 11.

291 Financial Rights Legal Centre submission, p. 9.

292 Legal Aid Queensland submission, p. 13.

293 saferhomes.nrma.com.au, IAG submission, p. 3.

Access to risk data

In its submission to this inquiry, Consumer Action Law Centre offered strong views on the role of data in insurance. It accepts that discrimination on the basis of individual risk, with appropriate data, can be legitimate in some circumstances. However it highlights that insurance is, by nature, a form of 'pooled risk', combining higher and lower risk customers. As insurers become more able to understand people's individual risk profiles, there is a significant risk that more 'uninsurable' groups of people will start to emerge.[294]

This is a particular concern where there is a lack of transparency not only of the data insurers rely on, but the algorithms and analysis used to make decisions on the basis of that data. Consumer Action, like other consumer and community interest stakeholders, are calling on insurers to be open about how they are using data, and how this complies with the law, including discrimination laws.[295]

Financial Rights indicated it supports greater access to information on natural hazard mapping, modelling, exposure and risk, noting that insurers are not currently required to make this information available to consumers and proposing that it be made available through a government-supported measure to ensure data consistency and reliability.[296] Hazard and risk data was also a topic addressed in submissions from local councils, many of whom discussed opportunities and partnerships to work with industry to improve insurance affordability through the provision of more granular, accurate data and by ensuring that land use planning takes into account natural hazard risks (or the risks are mitigated against).

Box 9.11 Extract of submission from Mackay Regional Council [297]

'...Council resolved in early 2017 to provide the Insurance Council of Australia and other insurers with Council's flood and ground level information. Every year, this information will be added to once new flood studies are completed. This information will also be available for residences via an online flood report tool that is currently being developed by Council.

The ICA undertook a first pass assessment of Council's data in February 2017 and advised that of the 68,212 addresses as identified by the ICA that fall within the suburbs of the data Council provided, the industry could reduce premiums based on lower risk categories supported by the new information by approximately $11 million for the region. The findings included:

- approximately $0 change for 76 per cent of ICA addresses
- approximately $500 premium saving for 22 per cent, and
- approximately $500 premium increase for 2 per cent of addresses.

Council has assisted by providing the best available flood information to residents and liaised with insurance providers about the flood risk. Sometimes this improved information had contributed to reduced premiums.'

In its submission to the inquiry, Floodplain Management Australia (FMA) shared a similar observation as Mackay Regional Council, claiming there is evidence that premiums for many properties with risk of flood often go down after local governments provide insurers with more up to date or sophisticated data. FMA added that creating greater consistency between governments' and insurers' understanding of risk in a local community reduces confusion and debate and improves the ability of all stakeholders to work together.[298] Chapter 12 on mitigation considers the sharing of risk data by government in more detail.

Several local councils also acknowledged the role for more community education to ensure consumers understood the role and limitations of hazard data prepared by councils and how this complemented and/or differed from that relied on by insures to set premiums. For example, Mackay Regional Council

294 CALC submission, p. 6.

295 CALC submission, p. 6; Legal Aid Queensland (LAQ) submission, p. 13; FRLC submission, p. 18.

296 Financial Rights Legal Centre submission, p. 13.

297 Mackay Regional Council submission, pp. 1, 3.

298 Floodplain Management Australia submission, p. 2.

indicated a community perception that the storm tide inundation and evacuation maps it publishes in its Emergency Action Guide are used by insurers for setting the flood risk for insurance. The Council believes this to be unlikely, as it is only storm tide, not riverine or local flooding risk.[299]

While not objecting to consumers having more access to hazard data and agreeing that it is likely to be beneficial, the insurance industry submitted that governments remain in the best position, and should have the responsibility, to provide natural hazard data to communities. Specifically, the ICA submitted that state and local governments should provide clear, concise and consumable hazard data for every household and business. It noted various efforts have commenced over the past decade and some jurisdictions have made progress.[300]

The ICA acknowledged its role in collecting, centralising and making hazard data available to insurers. It explained that individual insurers often combine this common data with their own data for use in underwriting, making it commercially sensitive. Each insurer then applies different methods for measuring risk, resulting in diverging assessments of the same risk.[301]

For example, one insurer may assess a household's flood risk to be 'medium', based on data collected by the ICA. Another insurer may have more detailed data from past claims experience and assess this same household as a high flood risk. The provision of inconsistent natural hazard data to consumers could create confusion, rather than be informative. For this reason, the industry believes governments remain in the best position, and have the responsibility, to provide natural hazard data to the public.

Furthermore, the ICA also submitted many insurers consider providing advice on exposure to hazards is personal financial advice, which they are restricted from providing. Recommendation 8 (earlier in this chapter), encourages industry to engage with ASIC on what guidance and advice insurers can give to individuals and may assist in addressing this concern.

As described in chapter 5, insurers sometimes cap premium increases for existing customers where a change in their risk assessments would otherwise lead to a substantial premium increase. While we appreciate an insurer's effort to protect a customer from a price shock, this must be balanced with the need for consumers to understand that price is an indicator of risk and therefore the general trend of their future premiums.

If a consumer is aware that their premium will continue to rise by a given percentage for the next several years, they will have a stronger incentive to consider mitigation activities. Similarly, this information would be relevant to a consumer's decision to rebuild or renovate on their property and assist with their financial planning more generally. Alternatively it may prompt the consumer to search for alternative insurance products to meet their needs.

Premium capping is usually an initiative for existing customers. New customers seeking new quotes will likely face the higher premium. So while a requirement for an insurer to advise any existing customer of a capping arrangement will signal its pricing intentions to those customers, we do not consider this requirement will provide the insurer's competitors with any information that they would not otherwise be able to obtain from quote sampling. That is, new quotes already show the insurer's assessment of the market.

Draft recommendation 6: Disclosure where premium increases are capped

The Insurance Contracts Act should be amended to require insurers that have capped premium increases for particular risks (to slow the rate of adjustment to a higher technical price or other pricing objective), to disclose this to an affected policy holder and provide an estimate of the timing and extent of premium increases that the insurer intends to apply in future.

This will allow consumers to recognise price as a signal of risk and prepare for potential future premium rises.

299 Mackay Regional Council submission, p. 2.

300 ICA submission, p. 34.

301 Ibid, p. 35.

The issue of risk disclosure at the time of property acquisition was also raised explicitly in several submissions. Cairns Regional Council pointed out that it's possible to buy (and equally, rent) a property in Queensland without having any idea of its propensity to flood or its proximity to sea level and thereby storm surge risk.[302] A local resident discussed a similar observation in their submission, sharing an example of a would-be purchaser of a new property seeking to avail themselves of the contract during the cooling-off period having subsequently received quotes for building insurance that they decided would not be affordable.[303]

Draft recommendation 7: Consider likely insurance costs before purchasing real estate

States and territories should implement measures to prompt consumers to investigate insurance costs when they are considering purchasing real estate.

As a first step, states and territories should include a statement in a statutory information disclosure for a real estate transaction advising any potential purchaser to obtain an insurance estimate as part of their due diligence.

If recommendation 5 (to review and mandate standard cover) is accepted, states and territories should mandate that a current home (building) insurance premium based on the standard cover product be listed in a statutory information disclosure for a real estate transaction.

This will provide prospective purchasers with a clearer expectation of the possible insurance costs associated with the property.

Privacy, including consumer access and third party disclosures

The General Insurance Code of Practice commits insurers to abiding by the principles of the *Privacy Act 1988* (Cth) when collecting, storing, using and disclosing personal information about applicants for insurance and policy holders (section 14 of the Code). The Code sets out that an individual will have access to information about themselves that an insurer has relied on in assessing an application for insurance cover, a claim or a complaint, if requested by an individual. If an insurer determines that it cannot provide an applicant with insurance, the Code requires the insurer to provide reasons and refer the applicant to other options, specifically the ICA, the NIBA or another insurer.

Insurers' privacy policies (or 'charters') set out where and from whom they collect personal information, as well as where it is stored and the full list of ways it could be used. Privacy policies typically include language to the effect of 'it's up to you to decide whether to give us your personal information, but without it we might not be able to do business with you, including not paying your claim'. These are the standard terms on which people deal with insurers.

The Consumer Action Law Centre expressed strong views on privacy in its submission and discussed what it considered to be an inconsistency in how insurers inform people about their privacy policies.[304] It said some insurers include privacy and third-party disclosure information in their PDS. At least one policy that Consumer Action reviewed did not mention privacy at all and another gives the insurer broad remit to: 'disclose your personal information to *others with whom we have business arrangements* for the purposes listed in the paragraph above or to enable them to offer their products and services to you'.[305] Consumer Action was of the view that, considering that very few people look at the PDS when they buy insurance, consumers are therefore very unlikely to understand how information about them is collected, used and shared.

302 Cairns Regional Council submission, p. 1.

303 Submission from R. Peterson.

304 Consumer Action Law Centre submission, p. 5.

305 Allianz, Home Insurance Product Disclosure Statement, prepared on 31 March 2015.

Consumers may request the information that is held about them by their insurer and some insurers encourage this through their privacy policy, for example the QBE policy states:

> Our aim is to always have accurate, complete, up-to-date and relevant personal information. When you deal with us, you should check the information we hold about you is correct. You can contact our Customer Care team to request access to personal information we hold about you and correct any errors. Generally no restrictions or charges apply.[306]

The Financial Rights Legal Centre also raised strong views about privacy and information sharing, and in particular drew attention to Insurance Reference Services Limited (IRS), submitting that most consumers would not be aware that they can also request a copy of their own insurance claims report from the IRS.[307] Financial Rights indicated that it had discussions with insurers in 2016 and more recently in October 2017, and it was told that the reports were haphazard, inconsistent and largely unreliable so that the current report provides minimal benefit to insurers or consumers.

The IRS holds a historical record of Australian insurance claims related information on behalf of its member. According to its website (insurancereferenceservices.com.au), this information is primarily used by these insurance companies and their third party agents to assist them in the validation of information provided to them by customers: from quotations and risk assessments through to claims.[308] The claims database highlights previously denied, withdrawn, or cancelled claims and multiple or unusual claim patterns. A 'My Insurance Claims Report' costs $22. It includes information that an individual has disclosed to insurance companies in the course of obtaining insurance and making a claim. It may include general identifying information (name, address, date of birth) as well as details of enquiries made by an agents of an insurer, such as a loss assessors and details of claims made under an insurance policies an individual has held. An individual can request changes to incorrect information.

The submission from Legal Aid Queensland also addressed privacy and personal information, stating that consumers should have full access to the information held about them by their insurer to ensure their risk assessment, pricing and claims assessment is based upon reliable information.[309] We agree with this view.

Draft recommendation 8: Requesting personal information held by insurers

The Insurance Contracts Regulations should be amended to require insurers to provide clear notice to consumers that they can obtain a copy of the information that the insurer holds about them, and contact details for doing so. This notice should be provided on a certificate of insurance and any renewal notices.

This will empower consumers to check and confirm their risk assessment, pricing and claims assessment is based upon reliable and verifiable information.

Consumer Data Right

In November 2017, the Australian Government announced the introduction of a Consumer Data Right.[310] The data right will improve consumers' ability to compare and switch between products and services and encourage competition between service providers.

In May 2018, the government made further announcements that it will reform the Australian data system and introduce a range of measures to implement the recommendations of the Productivity Commission's 2017 *Inquiry into data availability and use*. The government also announced in May its agreement to the recommendations of the 2017 *Open banking review*, both for the framework of the overarching Consumer Data Right and for the application of the right to Open Banking, with a phased

306 www.qbe.com/au/about/governance/privacy-policy.

307 Financial Rights Legal Centre submission, p. 22.

308 insurancereferenceservices.com.au/.

309 Legal Aid Queensland submission, p. 13.

310 ministers.pmc.gov.au/taylor/2017/australians-own-their-own-banking-energy-phone-and-internet-data—26 November 2017.

implementation from July 2019. The energy and telecommunications sectors are proposed to follow (and then rolled out economy wide on a sector by sector basis).

There are three key features underpinning these reforms[311]:

- A Consumer Data Right as a new competition and consumer measure to allow consumers to have greater control over their data.
- A National Data Commissioner to support a new data sharing framework and oversee the integrity of data sharing activities of Commonwealth agencies.
- Legislation to streamline data sharing and release, subject to strict data privacy and confidentiality provisions.

As the lead regulator, we have a number of new roles in relation to the consumer data right. We will be supported by the Office of the Australian Information Commissioner and the Data Standards Body as we develop the regulatory framework.

It is too early to say when consumer data right reforms could be rolled out to general insurance and announcements about the data right were made subsequent to the release of our Issues Paper. In any case, it is important and relevant and some consumer groups, the Financial Rights Legal Centre and Consumer Action Law Centre addressed the topic in their submissions.[312] Consumer Action proposed that consumers could use customer data in buying insurance, for example, to quickly and easily generate quotes and shop around. However, it remains concerned with data privacy, in particular, third-party disclosure, and discrimination on the basis of data. Financial Rights said that while it supported the development of a consumer data right, it does so provided a regulatory regime ensures consumers are adequately protected and able to realise the benefits from increased data sharing. An insurance data regime must be designed to benefit consumers—not only as individuals, but as a society.

311 accc.gov.au/focus-areas/consumer-data-right; static.treasury.gov.au/uploads/sites/1/2018/02/180208-CDR-Fact-Sheet-1.pdf.

312 Consumer Action Law Centre submission, p. 5; Financial Rights Legal Centre submission, p. 18.

10. Intermediaries and other third parties

Key points

- Insurance brokers can serve an important role in assessing risk, sourcing quotations, and in claims management. However there is a significant conflict of interest between an insurance broker's obligations to act on behalf of a consumer while being remunerated by an insurer. Disclosure of the conflict does not overcome the conflict.
- The use of intermediaries for home and/or contents insurance within northern Australia, and in particular northern Queensland, is more common than in the rest of Australia.
- Commissions paid to intermediaries in northern Australia can have a significant effect on the final premium that consumers are charged. Base commission rates of 15 to 20 per cent are common, and total incentive payments can reach in excess of 30 per cent of the cost of the premium. GST and stamp duty are then applied on the commission-inclusive amount.
- The different types of remuneration arrangements between intermediaries and insurers (including overrider or volume-based commissions, profit-share arrangements, and other non-monetary benefits) are not well understood by many consumers.
- There is no relationship between the size of the commission and the work undertaken by an intermediary. While commission payments can increase in line with rapidly rising base premiums the consumer does not receive any change to the level and quality of service being offered.
- Little incentive exists for intermediaries to secure a lower premium for their client or recommend products on which they don't receive a commission as this will also reduce their own remuneration.
- Insurers are competing for intermediaries through the remuneration arrangements they offer. Intermediaries can react strongly to attempts by insurers to reduce commission rates, including avoidance of the particular insurer, or through adverse selection of high-risk clients.
- Strata managers have similar remuneration arrangements with insurers and insurance brokers that create a conflict of interest with their role providing services to a body corporate.
- Comparison websites and insurance brokers only consider a sub-set of the market.

Distribution arrangements in northern Australia insurance markets are complex. In addition to the proliferation of brands which an insurer may use to market its products there are also numerous ways, or 'channels', through which a consumer may purchase insurance.[313]

A consumer may arrange their insurance:

- directly with the insurer
- through an intermediary acting on behalf of an insurer
- through an insurance broker (an intermediary acting on behalf of a consumer).

In addition, a number of other third parties can also play a role in connecting a consumer with an insurer:

- a referral network of affiliated businesses (such as bank branches, credit unions or motoring clubs)
- comparison websites, or
- a strata manager (also referred to as a body corporate manager).

Our analysis of industry data shows that the way in which an insurance product is purchased can have a significant impact on the final premium paid by a consumer, with commission payments and other incentives in some cases exceeding half the total cost of the insurance policy.

This chapter explains the role of intermediaries and other third parties, the prevalence of their use in northern Australia compared to the rest of the country, and explores the incentives created by complex remuneration arrangements.

313 Insurer branding is considered further in chapter 7.

10.1 The businesses that operate between insurers and consumers

In northern Australia, as in Australia more generally, the majority of consumers purchasing home and/or contents insurance engage directly with an insurer or an intermediary acting on behalf of the insurer. While the use of comparison websites is very low, an increasing number of consumers use the services of insurance broker.

Intermediaries facilitate the placement and purchase of insurance and sit between an insurer and a consumer. Intermediaries can been categorised as either insurer intermediaries or insurance brokers. The difference between the two relates to the manner in which they function in the marketplace and in whose interests they act.

'**Insurer intermediary**' means a person who, for reward and as an agent of an insurer, arranges contracts of insurance.

'**Insurance broker**' means a person who, for reward and as an agent for a consumer, a body corporate or representative of a body corporate, arranges contracts of insurance.

Insurers may also maintain **referral networks** of businesses that, while not directly arranging contracts of insurance, will refer customer details and contact information to an insurer in exchange for some form of remuneration (usually a commission). A specific type of referrer are **comparison websites** such as iSelect, or Canstar.

In the case of strata insurance products, **strata managers** also play a central role arranging insurance on behalf of a body corporate, but will typically also have a relationship with insurers and/or insurance brokers.

We will consider these types of entities in more detail below.

Insurer intermediaries

Insurer intermediaries generally conduct business for and on behalf of insurers. Agents represent the insurer in the insurance process and operate under the terms of an agency agreement with the insurer.

The insurer-agent relationship can take a number of different forms. In some markets, agents are 'independent' and work with more than one insurer (usually a small number of companies); in others, agents are 'exclusive'; either representing a single insurer in one geographic area or type of product.

Insurer intermediaries may also be companies or individuals that distribute 'white-label' insurance products under their own brand, such as Coles or Woolworths Insurance. Both supermarket chains do not directly manage the insurance products they sell, but rather act through an authorised representative agreement in exchange for commissions or other remuneration.[314] This particular arrangement contributes to the issue of brand diffusion, and the 'illusion of competition' it can create, which is more fully considered in chapter 7.

Insurance brokers

An insurance broker owes their primary duty of care to the insured, as principal.[315] Insurance brokers, as Australian Financial Services License (AFSL) holders, are required to do all things necessary to ensure that their services are provided efficiently, honestly and fairly. The broker's duty to their clients includes

314 As disclosed on their respective websites. See: financialservices.coles.com.au and insurance.woolworths.com.au.

315 A broker's duty is determined principally by the law of contract and negligence: *Johnson v Minet Mathers Ltd* (1989) 6 ANZ Ins Cas 60–968. See also *Corporations Act 2001* (Cth) ss. 961B, 961J, and, more generally, chapter 7. One exception is where an insurance broker acts on behalf of an insurer under a 'binder agreement' (where an insurer gives authorisation to an intermediary to enter into contracts and/or settle claims on their behalf) or other ceded authority, where the consumer must be clearly advised of this up front: *Holmark Construction Co Pty Ltd v Willis Faber Johnson & Higgins (NSW) Pty Ltd* (1988) 5 ANZ Ins Cas 6–877 (NSWSC).

determining their individual requirements, sourcing and providing advice on an appropriate product, and otherwise using reasonable care and skill to facilitate the insurance process.[316]

The National Insurance Brokers Association of Australia (NIBA), the peak industry body that represents insurance brokers in Australia, states that the role of the broker is:

> *...to discuss with the client the nature of their risks, give some advice where appropriate on the management and mitigation of those risks, work with the client to identify appropriate insurance coverage for those risks and ultimately negotiate coverage to the market. [If] a claim has to be pursued, the broker then assists the client with the pursuit of that claim to the insurer and the resolution of the claim.*[317]

Insurance brokers are usually contracted with multiple insurance companies in order to effectively obtain quotations and place coverage for their clients. This contract will set out the broker's remuneration arrangements (discussed further at section 10.3). As well as remuneration from an insurer, a broker fee may also be paid directly from the client (the consumer).

A single insurance broker may have contracts with dozens of insurers in order to facilitate quotation requests across multiple lines of business, however, for a residential policy such as domestic home or strata, a broker would usually approach on average three to five insurers for alternative quotations.[318]

We received submissions and feedback during our public forums[319] that acknowledge the role that an insurance broker can play in sourcing policies that are tailored to the purchaser and providing risk management advice, however some raised concerns over broker's remuneration arrangements and service levels.

Box 10.1 Extracts from submissions from local residents and property owners

'[I] have used a broker and have found sometimes still achieved a better rate for certain policies without use of a broker, however, do feel a lot more confident that I am getting correct coverage by use of a broker.'[320]

'I bought an investment property last year and an insurance broker was recommended to me and they are excellent. I suppose some people would just go with whatever their broker recommends but I do like to look at all the various policy options they present me so ultimately it's my decision. Having a broker is great from the perspective of not having to worry about renewal dates (and I'm sure claims as well though I've never had to make one).'[321]

'We use a broker and they are great. Of course they charge a fee but in the past have found it is much the same price as going through the company direct.'[322]

'[I] was using a broker and found it didn't get me a better price in the end so I searched myself. Brokers only use companies they get a kickback from.'[323]

'I made enquiries with a broker last year. They only gave me a choice of one policy ... I would prefer more to choose from and more detail from a broker. I don't know if they only review/recommend products that they receive commissions for etc.'[324]

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316 See *Corporations Act 2001* (Cth), s. 912A.

317 Mr Dallas Booth, Chief Executive Officer, National Insurance Brokers Association of Australia, *Committee Hansard*, Sydney, 14 October 2011, p. 5.

318 According to ASIC, a broker looking into a limited range of insurance products that might meet the needs of the client is subject to the modified best interests duty (s. 961B(4) of the *Corporations Act 2001* (Cth)) and they do not need to consider all options available.

319 See public forum summaries for Broome, Darwin, and Alice Springs as published on the Northern Australian Insurance Inquiry website: www.accc.gov.au/focus-areas/inquiries/northern-australia-insurance-inquiry/public-forums.

320 Submission from Anonymous 56.

321 Submission from Anonymous 116.

322 Submission from Anonymous 40.

323 Submission from N. Shaw.

324 Submission from F. O'Connor.

Referral networks

In order to generate leads, many insurers enter into ‘introducer’ or referral agreements with third-parties. These agreements are typically between an insurer and another financial service provider such as a bank or credit union where, during a transaction, the third-party can pass on consumer details to an insurer who will follow up with the consumer at a later time.

The third-party is unable to rely on the insurer’s AFSL and therefore cannot offer advice or discuss the suitability of a product. The third party only acts as a conduit between the consumer and insurer for factual information. Despite not being able to consider an insurance product’s suitability for a consumer, referrers can stand to receive significant remuneration from insurers when referred customers purchase an insurance product.

Comparison websites

As discussed in chapter 9, comparison websites, sometimes called comparator websites or aggregators, are generally online platforms that act as a third-party between insurers and consumers searching for a range of insurance products. Consumers are generally required to provide certain personal and property details online before being presented with information on a number of insurance products to compare.

As with referral networks more generally, comparison websites can contract with insurers to receive a payment (usually a commission or flat dollar amount per sale) when a customer referred from their website purchases an insurance product.

Of the eight insurers who hold the largest market shares in northern Australia, only two maintain current arrangements with commercial comparison websites. In these cases the websites receive either a base commission percentage of the total cost of the policy or a set fee per policy. Analysis of data from insurers shows that while a very small number of home, contents and strata insurance products in northern Australia are sold through comparison websites, the payment from an insurer to the comparison website is approximately 25 per cent of the product’s final cost in nine out of every ten cases.

Such costs are incorporated into the premium paid by consumers, but may not be clearly disclosed to them. Further, the range of products considered by comparison websites in northern Australia appears to be very narrow. We consider that it is reasonable that a consumer should be made aware of the commercial arrangements that exist between insurers and comparison websites, and which insurance products will (or will not) be compared.

Strata managers

At the time of buying into a strata or community title scheme, a unit owner becomes a member of a legal entity referred to as a body corporate (also referred to as an owners’ corporation). Depending on the body corporate’s size or complexity, its function, duties, and powers (including the purchase and renewal of insurance) may be delegated to a strata manager. This delegation is provided for in the relevant state or territory strata legislation [325] and will be set out in the terms of a strata management agreement between the body corporate and the strata manager or strata management company.

In this sense, a strata manager is an intermediary acting on behalf of the body corporate. However, in reality, strata managers’ arrangements and obligations are more complex.

When purchasing insurance, general market practice is for a strata manager to arrange cover either through an insurance broker or directly from a specialist underwriting agency. Given the complexity and regulatory requirements in arranging this type of insurance strata managers will usually engage an insurance broker. Strata Community Australia (QLD), the state branch of the peak industry body representing strata managers, conducted a survey of its members to inform its submission. It found

325 These are the *Strata Titles Act 1985* and Strata Titles Regulations 1996 in Western Australia, the *Unit Title Schemes Act 2009* and Unit Title Scheme (Management Modules) Regulations in the Northern Territory, and *The Body Corporate and Community Manager Act 1997* in Queensland.

that approximately 75 per cent of members indicated they will always use an insurance broker, with the remaining 25 per cent indicating that they would 'sometimes' use a broker.[326]

When arranging insurance a strata manager will do so in their capacity as either an authorised representative or a distributor for an Australian Financial Services (AFS) Licensee. This may be an insurer, an insurer intermediary who provides specialist strata products, or an insurance broker. This allows the strata manager, who is otherwise not entitled under law to deal in financial services, to source an insurance product and provide this to the committee as part of their management services.

In any case, authorised representative or distributor arrangements allow for commissions and other remuneration to be paid to the strata manager by either an insurer or an insurance broker. Where a strata manager engages an insurance broker, a common arrangement is for the strata manager to receive most, if not all, of the commission the insurance broker receives from the insurer. To offset this loss of commission income, the insurance broker may charge a higher fee for their service which is levied on top of the commission-inclusive premium, with the total cost borne by the body corporate.

On the matter of disclosure, under the *Corporations Act 2001* (Cth) (Corporations Act), strata managers appointed as representatives of a holder of an AFSL are required to provide a body corporate with a Financial Services Guide (FSG). In accordance with the Corporations Act, an FSG must include information about the remuneration (including commission) or other benefits that the strata manager is set to receive in respect of the provision of their services.[327]

Information about product pricing must also be disclosed to the body corporate in a Product Disclosure Statement (PDS) for the relevant strata insurance product. Moreover, as representatives of an AFS Licensee, in the provision of financial services strata managers are obligated under the Corporations Act to 'have in place adequate arrangements for the management of conflicts of interest that may arise'.[328]

In addition, a strata manager's activities are also bound by State and Territory legislation:

Box 10.2 Governing regulation for strata managers in northern Australia

In Western Australia, the relevant legislative instruments are the *Strata Titles Act 1985* (WA) and the Strata Titles General Regulations 1996. Recent amendments to the *Strata Titles Act 1985* (WA) will impose a comprehensive set of statutory duties on strata managers, including disclosure of commission or other consideration. These amendments received Royal Assent on 19 November 2018.

In the Northern Territory there are two Acts which govern body corporates depending on when the strata development was completed. Strata developments after 1 July 2009 are under the *Unit Title Schemes Act 2009* and Unit Title Scheme (Management Modules) Regulations*.* Strata developments prior to 1 July 2009 are covered under the *Unit Titles Act 1979* and Unit Titles (Management Modules) Regulations*.* Both Acts are silent on whether strata managers can receive commission or other consideration in the provision of their services and on any disclosure obligations.

In Queensland, *The Body Corporate and Community Management Act 1997* governs the administration of strata title schemes. This Act is silent on whether strata managers can receive commission or other consideration of their services, however there are disclosure requirements that must be made to a body corporate before entering into a management agreement, and at the AGM.

In some jurisdictions, strata managers are also subject to codes of conduct enshrined in the applicable strata legislation. In Queensland for example, strata managers are bound by the 'Code of conduct for body corporate managers and caretaking service contractors' contained in the *Body Corporate and Community Management Act 1997* (Qld). This code requires that in performing their functions, strata managers 'act honestly, fairly and professionally' and 'in the best interests of the body corporate unless it is unlawful to do so'.[329]

326 Strata Community Australia (QLD) submission, p. 2.

327 ASIC Regulatory Guide RG 175.88 (f).

328 See s. 912A(1)(aa) of the *Corporations Act 2001* (Cth) (the conflicts management obligation).

329 *Body Corporate and Community Management Act 1997* (Qld)—Schedule 2.3, p. 269.

We considered the remuneration structures of strata managers, and note that under a typical strata management agreement between a body corporate and strata manager, the range of a manager's duties and the corresponding fees are clearly laid out. Typically, a strata manager will, with the exception of arranging insurance, be remunerated through fees alone (rather than commissions).

Some strata management contracts expressly preclude the body corporate from arranging its own insurance. Although a contract may provide for the body corporate to elect to arrange its own insurance without the strata manager acting as an intermediary or accepting a commission. In many cases the body corporate will be required to pay an additional fee equivalent to the commission the strata manager might otherwise have received. This may significantly undermine the incentive for body corporate members to arrange their own insurance.

10.2 How do consumers purchase insurance in northern Australia?

The way in which an insurance product is purchased can have a significant impact on its suitability to the consumer's individual requirements, the incentives of those who sell the product, and the final premium charged.

As part of our inquiry, we obtained detailed information about how insurance products are purchased across Australia, with a focus on the 2017–18 financial year. We have grouped the main distribution channels used when the product purchased was either a home and/or contents product, or a strata product.

Taken together, the use of intermediaries within northern Australia is far greater than for the rest of the country, with insurance brokers particularly utilised. This suggests that finding appropriate or alternative products within northern Australia is challenging and that there is a greater reliance on brokers to do this.

We will consider in section 10.3 the ramifications of these purchase methods, especially as they relate to commissions.

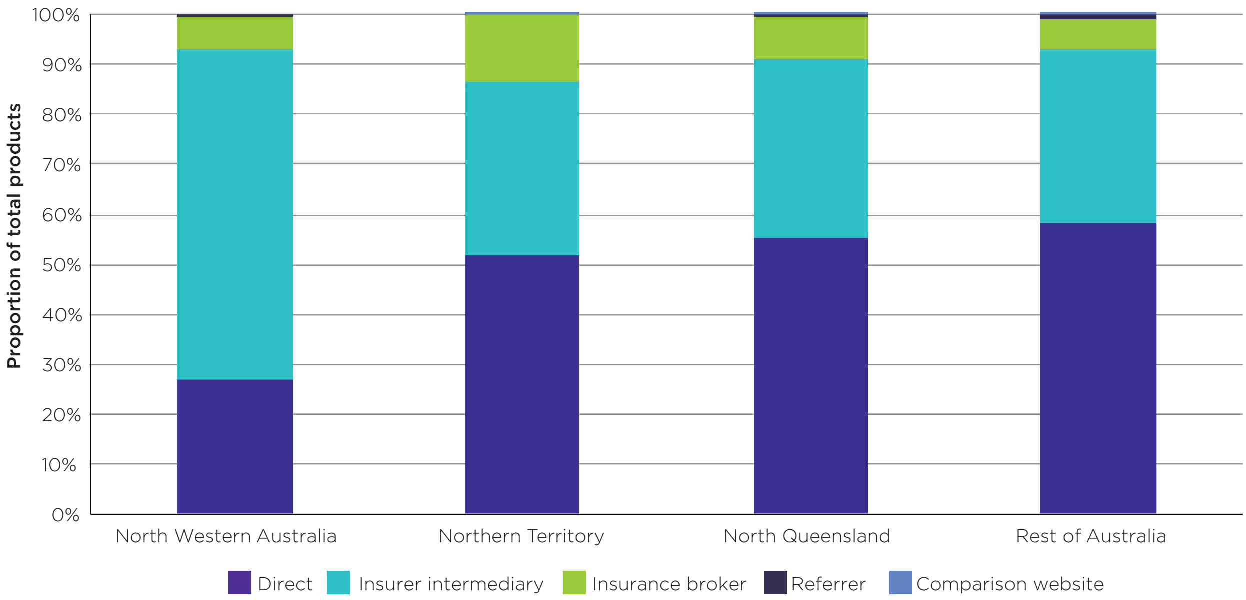
In 2014, ASIC conducted a review of the sale of home insurance and found that of 514 194 policies sold, 6.2 per cent were sold by insurance brokers.[330]

Data we obtained from insurers of over 8.6 million home and/or contents policies sold in the last financial year 2017–18 shows that the use of insurance brokers is generally consistent to what was calculated by ASIC at a national level, however we found there is a higher use of insurance brokers within northern Australia.

Figure 10.1 shows the purchase of a home and/or contents product by distribution channel.

330 ASIC Report 415, *Review of the sale of home insurance,* October 2014.

Figure 10.1: Sales by distribution channel for home and/or contents insurance, 2017–18



Source: ACCC analysis of data obtained from insurers.

The use of intermediaries in northern Australia is overall fairly consistent. We consider that the marginal increase in their use may indicate that some customers are actively seeking out assistance in providing alternative cover options and minimising the cost of their policies, or as in the case of north Western Australia, a reflection of the small number of policies sold.

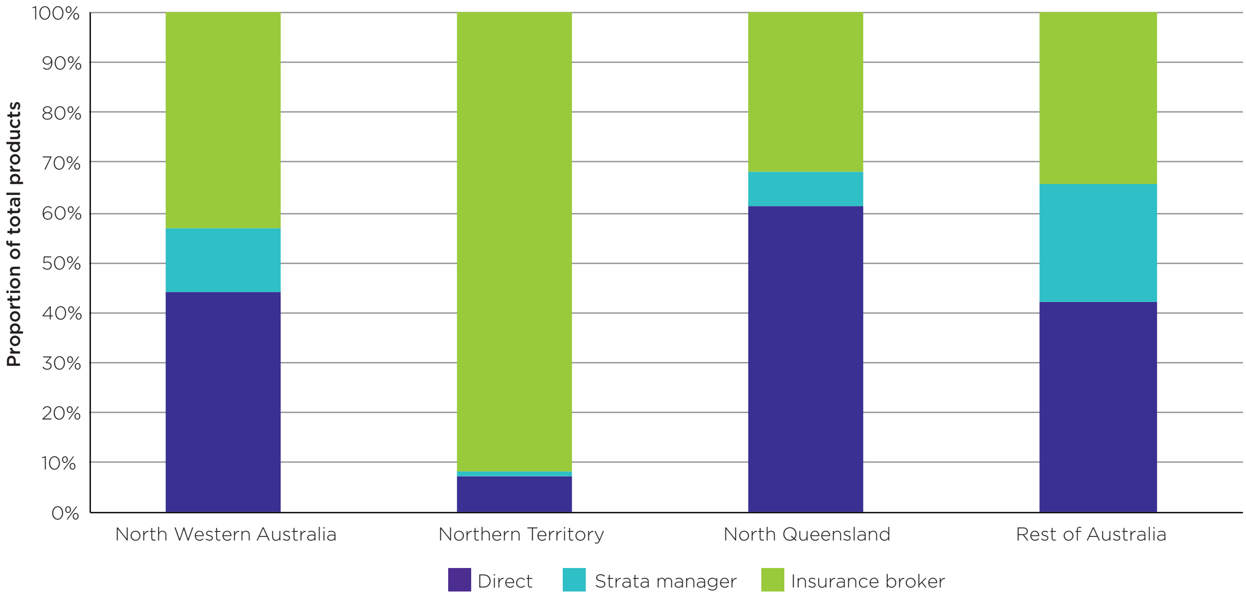
For example, it was found that a consumer will purchase their home and/or contents policy through an insurance broker approximately seven per cent of the time in the north of Western Australia, approximately 13 per cent of the time in the Northern Territory, and approximately nine per cent of the time in north Queensland. This compares to just over six per cent in the rest of Australia.

The use of insurer intermediaries is also consistent across Australia with the exception of north Western Australia where they account for approximately 65 per cent of policies purchased, as above we note that this is likely a reflection of the small number of policies sold in this region.

Referrers (including comparison websites) represent less than one per cent of the total distribution of home and/or contents products across Australia. This is not surprising as only two of the insurers we obtained data from have agreements with comparison websites. The use of comparison websites in Australia as a whole has not formed part of our analysis, although we anticipate it is low.

We have also considered the purchase of strata products across Australia. Figure 10.2 shows the purchase of a strata product by distribution channel.

Figure 10.2: Sales by distribution channel for strata insurance, 2017–18



Source: ACCC analysis of data obtained from insurers. Data shown excludes one insurer as distribution breakdown was not able to be provided.

For the purposes of this representation, **direct** refers to a product sold by an insurer to a body corporate committee, **strata manager** refers to a product sold by an insurer to a strata manager, and **insurance broker** refers to a product arranged through an insurance broker (either by a strata manager or a body corporate committee).

It is apparent that in north Queensland a significant proportion of the policies are purchased directly from an insurance company by the body corporate committee. We expect that this feature of the data, compared to the rest of Australia, is due to the nature of strata developments in the north of the state. It is expected that there are a higher number of smaller or less complex strata developments (one to four lots) in North Queensland and as such they may not engage the services of a strata manager. We expect however that larger or more complex strata developments, which also attract a proportionately larger premium, will engage the services of a strata manager or insurance broker more frequently.

10.3 Commissions and conflicts

There are numerous monetary and non-monetary ways that an insurer can incentivise an intermediary to sell their products. These are shown in box 10.3.

Box 10.3 Types of incentives paid to intermediaries

The most prevalent type of commission payment is a base commission paid at an agreed percentage of the cost of the policy, less government fees and charges. The rate of commission ranges from 0 to 30 per cent for insurance brokers, while for insurer intermediaries and referrers the rate of commission generally ranges from 0 to 15 per cent.

An **'overrider' commission** or volume payment is an incentive paid to an intermediary, referrer, or comparison website as a reward for placing a large amount of premium with an insurer. The rate of commission ranges from one to three per cent of the total gross written premium and is in addition to any other commission arrangements. These payments may also be in the form of a contingent lump sum amount.

Profit-share agreements refer to payments made to an intermediary, referrer, or comparison website by an insurer after certain profit targets have been met. Profit is generally calculated on the gross written premium placed through the intermediary, referrer, or comparison website with the insurer **less** the insurer's operating expenses, incurred claims expenses, and other commissions paid.

An insurer may also pay a **management fee** for the supply of services such as claims handling and basic administration by the intermediary, though may more likely be used as an incentive during contract negotiations. Management fees will generally be a percentage of the total gross written premium or a defined dollar amount. These can be significant and into the millions of dollars per year for a large contract.

Non-monetary incentives are incentives provided to an intermediary, referrer, or comparison website by an insurer and may include such things as sponsorship arrangements, access to training and development or specialised IT systems, and insurer hosted social events.

The amount of remuneration is determined by the terms of the contract that an intermediary, referrer, or comparison website enters into with an insurer. Commissions and other incentives can have a significant effect on the final premium that consumers are charged. It is apparent from information obtained by the ACCC that these complex remuneration arrangements are not well understood or even known to exist by many consumers.

The scale of payments to intermediaries and referrers

The amount of commissions and other payments made to intermediaries and referrers is significant. In the 2017–18 financial year alone, the total of commissions and other incentives paid for home and/or contents and strata products was over $650 million nationally, $62 million (approximately 9.5 per cent) of this in northern Australia.

From information obtained by this inquiry, we have determined the rates of effective commission (including base commissions and other payments) for both home and/or contents and strata products across Australia. These are shown below in figure 10.3.

Figure 10.3: Average effective commission rate by distribution channel for home and/or contents products, 2017–18

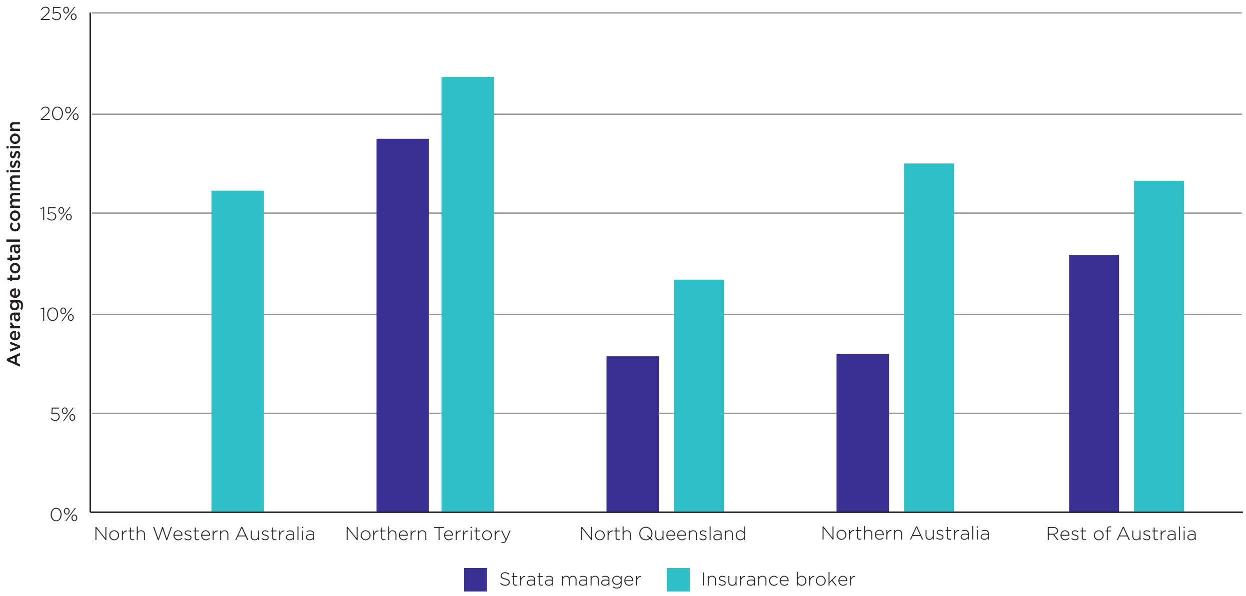
Source: ACCC analysis of data obtained from insurers.

For the year 2017–18, the average effective commission rate for home and/or contents policies in northern Australia was approximately 18 per cent, compared to approximately 21 per cent for the rest of Australia.

Effective commission rates are only slightly under the average for the rest of Australia and, as discussed in chapter 3, this is despite the average home and/or contents premium for consumers in northern Australia being substantially higher. This suggests that intermediaries are still accepting significant base commissions and other payments from insurers.

We find that the average rate of commissions and other payments for insurance brokers in particular to be notable, with approximately 24 per cent of the total premium paid by consumers in northern Australia attributable to an incentive of some description. In some instances this figure can exceed 30 per cent of the total cost of the product.

Figure 10.4: Average effective commission rate by distribution channel for strata products, 2017–18



Source: ACCC analysis of data obtained from insurers. Data shown excludes one insurer as distribution breakdown was not able to be provided.

Note: In north Western Australia the number of strata policies sold directly to a strata manager is very small (less than 15) and no commission has been paid on these policies through this distribution channel.

We also considered the purchase of strata products and note that insurance brokers are again accepting a much larger effective commission rate than strata managers. This is true for both northern Australia and the rest of the country, however it is more prominent in northern Australia where an insurance broker is on average receiving an effective commission rate nearly 10 per cent higher than that received by a strata manager purchasing directly from an insurer.

An important caveat is that the data provided does not capture payments to strata managers by insurance brokers as part as their own arrangements. It may be that while insurance brokers are accepting a much higher percentage of commission than strata managers, as part of their agreement with the strata manager, the broker may cede most if not all of the commission received. In any case, the amount is ultimately paid by the strata unit owners.

Across home, contents and strata insurance products in Australia, insurance brokers are paid, on average, an effective rate of commission approximately eight per cent higher than insurer intermediaries or referrers working on behalf of an insurer. We find this result at odds with what a consumer could reasonably expect from an insurance broker working on their behalf. Considering the pricing pressures discussed in chapter 3 of this report, this high effective rate of commission represents a significant cost for consumers.

We acknowledge the important role that insurance brokers play in the insurance process, and in their ability in negotiation and sourcing difficult to place or in some cases, more competitive insurance options for consumers. We also note that commissions such as those received by intermediaries are not currently restricted. However, the high rates of commissions charged throughout northern Australia indicate that consumers may not be well served by prevailing remuneration arrangements that a largely contingent on the size of insurance premiums.

What has been said in the past and has anything changed?

The issues of commissions and the potential conflicts to which they may give rise have been considered in previous reviews and inquiries.

In 2012, the House of Representatives Standing Committee on Social Policy and Legal Affairs described commission payments as having an extremely detrimental effect on the cost of a policy, especially when premiums are increasing:

> *As policy premium costs have increased, so have the commission costs (such as Body Corporate manager or insurance broker fees) that are added to premiums and then passed on to individual unit owners. While commission costs are not drivers of premium increases, their commensurate dollar value rises as premium costs rise, and so they therefore contribute to overall price increases.*[331]

The House Committee made a number of recommendations including to:

- improve the information and educational resources available to bodies corporate so they are more aware of contractual obligations of disclosure around fees and commissions, and
- consider regulation to increase transparency in the disclosure of commissions and fees taken by intermediaries.

In 2015, the Northern Australia Insurance Premium Taskforce report approached the issue of the affordability of insurance within northern Australia and determined, again, that commission payments were a potential source of conflict, and acted as a disincentive to strata managers to obtain insurance that represents the best value for money.[332]

The Taskforce considered matters of disclosure regimes around Australia and recommended that:

> State governments could consider reforms that highlight alternatives to commissions, such as fee-based systems, as a means of payment for strata management services.[333]

The Australian Government proceeded with a set of reforms in response to this report but in 2017 referred matters of the regulation of strata commissions and strata title legislation changes to state governments.

In 2017, the Senate Economics References Committee also highlighted as a key concern commission payments to strata managers and raised concerns about the transparency of disclosure of commissions to strata scheme members, and whether such arrangements represent a conflict of interest.

Ultimately, the Senate Committee formed the view that 'the current disclosure requirements relating to the payment of insurance commissions to strata managers are insufficient and do not provide adequate transparency to body corporate members.'[334] They made two recommendations:

- that the government strongly consider introducing legislation to require all insurance intermediaries to disclose component pricing, including commissions payable to strata managers, on strata insurance quotations, and
- that state and territory governments strengthen disclosure requirements in relation to the payment of commissions to strata managers.

The Australian Government noted these recommendations and referred them to the state and/or territory governments who retain overall responsibility for regulation of strata managers.

In the September 2018 interim report of the Financial Services Royal Commission, Commissioner Kenneth Hayne considered at length the role that misaligned incentives can have in the provision of financial advice. On the issue of conflicted remuneration, the Commissioner expressed the view that:

> 'sales staff can be rewarded by commission; advisers should not be.'[335]

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331 House Standing Committee on Social Policy and Legal Affairs, *In the Wake of Disasters Volume Two: The affordability of residential strata title insurance,* March 2012, p. 69.

332 Northern Australia Insurance Premium Task Force, *Final Report*, November 2015, p. 77.

333 Ibid, p. 78.

334 Senate Economics References Committee, *Australia's general insurance industry: sapping consumers of the will to compare,* August 2017, p. 70.

335 Financial Services Royal Commission, *Interim Report Volume 1*, September 2018, p. 98.

The effect of intermediary remuneration arrangements

We note the distinction between an insurance broker and an insurer intermediary is very significant when considering the effect of remuneration arrangements. An insurer intermediary, by definition, should act on behalf of the insurer. In many respects they are akin to sales staff of an insurer. In most cases, an insurer intermediary will act on behalf of a single insurer.

In contrast, an insurance broker, by definition, should act on behalf of a consumer although they may have remuneration arrangements in place with a number of insurers. There is clearly a much greater potential for an insurance broker's remuneration arrangements with insurers to lead to a conflict of interest with their obligation to act on behalf of a consumer.

When insurance is sold through an intermediary there are certain disclosure requirements that must be followed. The intermediary must provide the consumer with a FSG which discloses information about the financial services offered, remuneration arrangements, and any potential conflicts of interest.

Despite this risk, current disclosure requirements only offer a limited degree of transparency regarding the actual remuneration paid. For instance, a common disclosure clause within an FSG may state that an intermediary, upon placing the insurance, will receive a commission that varies between 0 and 25 or 30 per cent of the base premium paid. Information obtained in this inquiry indicates that the majority of base commission payments are made at the higher end of the possible range indicated. When all other remuneration payments are considered actual commission rates may exceed 30 per cent of the final cost of the product.

A recurring theme of stakeholder submissions to this inquiry is that there is confusion regarding how intermediaries (including insurance brokers and strata managers) are remunerated by insurers and who ultimately bear the cost of these payments. This confusion suggests that current disclosure regimes may not be adequate when an intermediary has a clear conflict of interest.

Residents in northern Australia expressed their concern that large commissions add to the financial strain of already high insurance premiums. In cases where a premium has risen 100 to 300 per cent so too has the underlying base commission as a proportion of this premium.

In addition, these types of base commission payments attract GST, on which state or territory government stamp duties are levied, which further increase the final cost for the consumer. An example of this is shown below in box 10.4.

Box 10.4 Example of application of base commission and its effects on policy pricing

A home and contents policy in regional Queensland is sourced through an insurance broker who has an arrangement with an insurer to receive 20 per cent commission for this type of policy. The insurer calculates that, based on the property details, the location, and other relevant data that the initial base premium is $1000. To this the insurer adds $200 in commission (being 20 per cent of the calculated premium) bringing the total base premium to $1200.

The insurer must then also apply the applicable GST and state government stamp duty (in this case, nine per cent duty applied in Queensland) bringing the total premium that the customer pays to $1439. Without the commission, the premium (including taxes) would be $1210.

For strata complexes where the premiums may be in the tens or hundreds of thousands of dollars the corresponding commission payment can be significant.

On base commissions, consumers questioned whether it was fair or reasonable to link an intermediary's remuneration to the premium alone and argued that there is no relationship between the size of a commission and quality or amount of work undertaken by an intermediary.[336]

336 Cairns public forum summary, 16 November 2017.

On the other hand, industry submissions to this inquiry suggest that commissions are a reasonable payment for services such as claims administration and risk management that may be provided by the intermediary.[337] They argue that the removal of commissions would not increase or otherwise affect competition in northern Australia.[338]

Information obtained from one insurer suggests that the rate of commission is correlated with the premium that is charged to the consumer and to the likelihood of a product being recommended by a broker.

That insurer made a decision to reduce the base commission rates paid to insurance brokers on residential products to 15 per cent. It found that the change in commission, with no other changes made to the policy wording to effect its suitability, led to a significant reduction in the number of policies sold through insurance brokers and profit.

We consider it may be that, faced with a lower commission payment, brokers elected to stop recommending the insurers product in part or in full, or to only place risks with them in high hazard areas where there were few other competitive options. In order to mitigate any further loss of viability to their product offering, the insurer discussed and re-introduced the ability for brokers to scale the base commission up to 22.5 per cent. The manner in which insurers compete for the business of intermediaries is considered in more detail in chapter 7.

Submissions by property owners and body corporate committees provide examples of significant premium reductions being achieved by removing commissions from the premium. Consumers spoke of no longer using an intermediary (such as a strata manager or insurance broker) that charges a commission or, where possible, moving to a more transparent fee-for-service model.[339]

We consider that, where an insurance broker preferences one insurer over another based on the amount of commission received, a conflict of interest may arise and that such a conflict would run counter to the interests of consumers.

Other types of commission that consumers may not be fully aware of are overrider or volume-based commissions. These are usually made to the intermediary once or twice a year and are directly contingent on the sales of a particular product or within a geographic region.

Volume-based payments have come under recent scrutiny for the conflicts they create in sales based industries and the potential for misconduct that these types of incentives promote.[340] In a 2017 review, ASIC commented that these types of payments created a conflict of interest for aggregators or brokers and that consumers were at 'higher risk' of being recommended a product for the wrong reasons.

In addition to the supply of base commissions and volume-based payments, insurers will also enter into profit-share agreements with intermediaries as a further way to incentivise the sale of their products. The calculations for these payments hinge on the entire 'book' of business that an intermediary places with an insurer performing well with respect to gross written premium earned by the insurer less any claims that have been paid in the period. The insurer may also factor in policy retention rates (the percentage of policies not moved away from the insurer), and new business targets, but the key factor in determining the amount of profit is heavily weighted towards minimising claims payments.

It appears from information obtained by this inquiry that the size of these payments can vary considerably, especially in adverse years where high claims payments erode profits. However, intermediaries can be entitled to 50 to 75 per cent of the insurer's profit on the policies they place with them. A potential for conflict arises from these arrangements if the insurance broker will be rewarded by the minimised or reduced success of their customers' claims.

Insurers may also pay intermediaries a management fee as a part of their agreements. A management fee for the provision of claims or other administration service by an intermediary may be acceptable in some circumstances but may be a further method to incentivise an intermediary placing business with a

337 Allianz submission, p. 29.

338 National Insurance Brokers Association (NIBA) submission, p. 6.

339 Townsville public forum summary, 15 November 2017.

340 Financial Services Royal Commission, *Interim Report Volume 1*, September 2018, pp. 61–62.

particular insurer. This is especially so where the management fee is determined by a flat payment plus a percentage of the total gross written premium placed with the insurer.

An intermediary may also be paid a commission for other related services. An example is premium funding, which is where an insurance broker arranges a short-term loan (often for the length of the policy) to allow the purchaser of the product to pay the cost of the premium over time. For example, faced with a higher than expected insurance premium, a body corporate may need to rely on a premium funder until additional funds can be obtained from unit owners. These are in effect loans with interest, and for placement of these loans the intermediary is paid a commission of one to two per cent of the total loan amount.

As has been seen in other financial services reforms, under a commission-based system there is an unavoidable conflict of interest for intermediaries that are simultaneously acting as an agent for a consumer but being remunerated by an insurer. It is not clear that this conflict can be adequately managed through disclosure requirements alone.

The general insurance industry has remained exempt from recent major financial reforms that have sought to tackle issues of potential misconduct by financial advisors. Of particular relevance are the 2013 reforms as part of the Future of Financial Advice (FOFA) legislation which was introduced following the failure of major financial advisors and in response to the Parliamentary Joint Committee inquiry.[341]

The objectives of FOFA were to improve trust and confidence in the financial sector, and to protect consumers from misconduct or poor advice. It introduced three major objectives:

- the introduction of 'the best interest duty' to ensure advisors keep the objectives and needs of consumers above their own
- a ban on 'conflicted remuneration', or any payment that could influence an advisor in recommending a product, and
- clearer disclosure of fees and other payments by consumers.

Conflicted remuneration means any type of remuneration (including commissions) given to a financial services licensee, or their representative, who provides financial product advice that, because of the nature or circumstances of the remuneration arrangements:

(a) could reasonably be expected to influence the choice of financial product that is recommended, or

(b) could reasonably be expected to influence the financial product advice given.[342]

The activities of advisors in relation to general insurance was specifically excluded from these reforms.[343] This appears inconsistent with the information obtained and the submissions received in the course of this inquiry, where disclosure may not be adequate in complex remuneration structures that can be seen to influence an intermediary's advice.

In November 2018, in its response to the interim report of the Financial Services Royal Commission, ASIC identifies that conflicted remuneration has led to consumer harms which are entrenched across a wide range of financial services, including general insurance. ASIC considers that disclosure alone is not an effective means of overcoming consumer's misconception about the capacity in which an [intermediary] is acting and they recommend that conflicted remuneration in financial services should be prohibited or removed as a general policy.

We also consider that the exemption from the prohibition of conflicted remuneration should be removed for insurance brokers. Where commissions and other benefits provided to insurance brokers could reasonably be expected to influence what insurance products they recommend or what advice

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341 The Parliamentary Joint Committee on Corporations and Financial Services chaired by Mr Bernie Ripoll MP, conducted an inquiry into financial product company collapses. See: www.aph.gov.au/Parliamentary_Business/Committees/Joint/Corporations_and_Financial_Services/Completed_inquiries/2008-10/fps/index.

342 See s. 963A of the *Corporations Act 2001* (Cth).

343 A benefit is not conflicted remuneration if the benefit is given in relation to a general insurance product. See: Corporations Regulations 2001, Reg 7.7A.12G.

they give, there is a conflict with their obligation to act in the best interests of their clients. We consider that disclosure is not sufficient to deal with the conflict of interest.

We consider that providing a clear, fee-for-service model to consumers is preferred to the remuneration arrangements described above, as they avoid inherent conflicts of interest that exist.

Recommendation 11: Extend the ban on conflicted remuneration to insurance brokers

The Corporations Regulations should be amended to remove the exemption for general insurance retail products from the conflicted remuneration provisions as they apply to insurance brokers.

Commissions and other benefits given to insurance brokers can give rise to an unacceptable conflict of interest. As is already the case for other financial products, insurance brokers should be prohibited from receiving commissions and other benefits where these create a conflict with a broker's obligation to act in the best interest of their clients. Disclosure alone is insufficient to address these conflicts.

Strata managers

As discussed in section 10.1, a strata manager may either enter into an authorised representative or distributor agreement with an insurer, a broker, or both. The differences between these agreements is primarily in the types of advice that the strata manager can give, with only general advice allowed under the authorised representative model and no advice at all under the distributor model. Either agreement allows a strata manager, who does not otherwise hold an AFSL, to deal in financial products and receive commission payments in relation to this dealing.

Numerous submissions to our inquiry from members of the public, bodies corporate, and consumer groups raise concern at the high rate of commissions paid to strata managers, either directly or through an insurance broker, for their role in arranging insurance on behalf of a body corporate.

Legal Aid Queensland provided a summary of complaints received by its consumer protection unit lawyers with regards to the services provided by strata managers:[344]

- Strata managers are engaging brokers who agree to share commission received from the insurer with the strata manager. The percentage of commission shared is a relevant factor in which broker is selected.
- Strata managers are not using, or making no effort to find, the most appropriate broker or broking arrangement for the strata properties they manage and are instead focused on maximising their revenue. It is alleged there are many instances where the strata manager and broker are not operating at arm's length and that it is common for the broker to be an associate or subsidiary of the strata manager and/or its owners.
- Strata managers are influencing the broker's policy selection by having a bias towards those policies that generate a greater commission for the strata manager and incidentally the broker. Strata committees are consequently purchasing policies that may not be the most desirable policy for their strata property, whether by its terms and/or the policy's price.
- Strata managers are obstructing committees from contacting the broker selected by the strata manager, and brokers more generally, to request further details to assist them evaluate policies offered.
- Strata managers are becoming involved in committee elections to ensure committees that are elected are favourable to them so they do not lose the fees earnt through their management and related broking services.

344 Legal Aid Queensland submission, p. 5.

Consumers also expressed frustration and disenchantment with unclear or conflicted arrangements between strata managers and insurers and the perceived lack of independence of strata managers. Examples of stakeholder views on strata managers are presented in box 10.5.

Box 10.5 Extracts of submission received by members of the public and industry bodies regarding strata managers

'It is not uncommon for Body Corporate Management companies to receive a commission of up to 30 per cent of the total cost of insurance. This can amount to tens of thousands of dollars per scheme in insurance commissions…Rewards should be based on activity and Body Corporate Managers and Brokers should be required to submit a clear fixed hourly rate for activity in relation to the administration of body corporate insurance.'[345]

'Some [strata managers] charge for claims handling when the property is not insured through their preferred broker. My Body Corporate Management Company will charge $190 per hour + GST for handling our claims because we used a different broker to theirs.'[346]

'Very few body corporate managers in Qld or anywhere else in Australia hold an Australian Financial Services Licence, issued by ASIC, to provide advice on financial products, including insurance policies, whereas all Brokers do. Why should this practice of insurance companies paying commission direct to [strata managers] be legal?'[347]

While these examples may be attributed to a small number of strata managers working within the sector, much like insurance brokers, there is an inherent conflict between the interests of their clients and their own financial interests when a significant portion of their revenue is derived through commission payments from insurers or insurance brokers.

We acknowledge that the complexities and varied duties of managing a strata complex require remuneration under a management agreement. However, the remuneration arrangements of a strata manager should not incentivise higher premiums for their clients.

Remuneration arrangements should remain a matter for negotiation and agreement between the strata manager and their client. While it would be open for a strata manager to seek a fee set with reference to the strata premium paid (that is, just like a commission), we consider it far more likely that strata managers and their clients would agree to arrangements that more closely aligned their interests.

Draft recommendation 9: Strata managers to be remunerated by body corporate only

State and territory legislation governing strata managers should be amended to prohibit strata managers from accepting payments in relation to arranging strata insurance other than those agreed to, and made by, their body corporate.

Strata managers should be required to negotiate any fees or payments for arranging insurance directly with the body corporate they are servicing. This would encourage remuneration arrangements that better aligned the interests of the strata manager and their clients.

The range of options considered by comparison websites and brokers

In our 2015 consumer and industry guidance on the operation and use of comparator websites we identified a number of concerns with some comparison websites over a lack of transparency in regards to the:

- extent of the comparison service, including market coverage
- savings achieved by using the comparison service

345 Submission from the Australian Resident Accommodation Managers' Association & Owners Corporation Network, p. 2.

346 Submission from M. Shaw, p. 20.

347 Supplementary submission from M. Shaw, p. 13

- comparison services being unbiased, impartial or independent
- value rankings
- undisclosed commercial relationships affecting recommendations to consumers, and
- content and quality assurance of product information.[348]

ASIC raised similar issues during a review on insurance specific comparison websites and found that on some websites:

- there was insufficient disclosure relating to website operators who were related to the issuer of the insurance brands being compared
- comparisons were provided on the basis of price without any warning that different products may have different features and levels of coverage, and
- the operators of websites are not appropriately licensed or authorised to provide financial services.[349]

In our June 2018 Retail Electricity Pricing Inquiry Report, we expressed concern that many consumers are likely to assume that websites display all of the product offers and retailers available or present in the market. We concluded that:

> third party intermediaries do not always make recommendations that are in the best interests of consumers [and] third party intermediaries do not always adequately disclose the number of retailers and offers that they consider in making a recommendation to a consumer.[350]

As noted above, the current remuneration arrangements will incentivise insurance brokers to recommend some products over others. Further, it will also influence which insurers and products they consider in the first place. So, while it is not practical in many instances, insurance brokers (as with comparison websites) will not generally have arrangements in place with all active insurers in the markets that they operate.

Removing the potential for conflicted remuneration of an insurance broker (as recommended above) may increase the number of insurers a broker considers but they would generally still only consider a sub-set of the market. It is, therefore, important that consumers are aware of the limitations of the search being conducted by a comparison website or insurance broker, and the scale of any payments they stand to receive.

Draft recommendation 10: Clear disclosure of products considered and remuneration

The Corporations Regulations should be amended to require comparison websites and insurance brokers to disclose a complete list of what home, contents, or strata insurance products they will consider when making a comparison or providing a recommendation to a consumer. If recommendation 3 (insurers to report their brands and where they are writing new business) is adopted, this disclosure should also refer consumers to this information. Finally, comparison websites should also be required to disclose the amount of commission and other remuneration that they receive for each product.

Comparison websites and insurance brokers only consider a sub-set of the market when providing a quotation or recommendations. Consumers should clearly understand the breadth of search undertaken by the comparison website or insurance broker they are looking to use.

348 See: www.accc.gov.au/media-release/accc-releases-comparator-website-guidance.

349 asic.gov.au/about-asic/news-centre/find-a-media-release/2012-releases/12-304mr-asic-warns-comparison-websites/.

350 ACCC, *Restoring electricity affordability and Australia's competitive advantage, Retail Electricity Pricing Inquiry—Final Report*, June 2018, p. 275. Note that, under new laws being considered by the New South Wales government, businesses will be penalised for failing to disclose intermediary referral fees and commissions, and failing to advise consumers of the effect of non-disclosure clauses.

11. Claims processes and dispute resolution

Key points

- Insurers' claims handling was a significant theme of our public consultation. Some local residents and property owners across northern Australia shared positive claims handling experiences, but many people shared examples of experiences that fell well below what they thought reasonable to expect.
- People told us about lengthy delays in claims settlement, excessive repair quotes and numerous cases of unsatisfactory work. It was clear to us that this exacerbated the distress and trauma these residents were already experiencing as a result of their losses.
- Submissions from stakeholders highlighted a range of potential problems that can arise when insurers decide to cash-settle claims, particularly when the settlement amount is based on trade prices that would not be available to the consumer paying market prices.
- There are a range of circumstances where a consumer may prefer a cash settlement and we consider that, subject to certain safeguards, the manner in which a claim is settled should be at the discretion of the consumer.
- It was apparent from submissions that many consumers are not adequately aware of their rights to make a complaint to their insurer or to escalate complaints to the Financial Ombudsman Service (whose functions as of 1 November 2018 are now performed by the Australian Financial Complaints Authority). We consider consumers need to be explicitly reminded of this at the time of lodging a claim, not just when taking out a policy.
- Stakeholders with experience in the building industry, among others, raised concern about the lack of independence of loss adjusters and other third parties engaged by insurers to assess damages and prepare scope of works. Property owners recognised the disparity in outcomes depending on how the initial claim was assessed and by whom. It is clear that consumers need to be made aware at the time they lodge a claim that loss adjusters are an agent of the insurer and not the consumer.
- Property owners also want to have more control over who undertook repairs, claiming insurers should preference local tradespeople who are more familiar with local conditions and regulations. Insurers explained panel arrangements with suppliers are often more cost and time efficient.
- The General Insurance Code of Practice (the Code) sets out minimum standards insurers must meet in handling claims and complaints. While natural disasters and catastrophes that give rise to a high volume of claims can stretch insurers' capacity to meet the Code standards, the effectiveness of the Code in otherwise maintaining high standards of practice was not clear; it is a voluntary code with minimal repercussion for breaching it. The Code would benefit from further revisions working towards the Australian Securities and Investment Commission's (ASIC) approval.

This chapter considers insurers' processes in the event of a claim, including how claims are settled. It discusses the role of loss adjusters[351] as well as insurers' arrangements with tradespeople.[352] It also considers dispute resolution options available to consumers and compliance with the Code.

351 In this chapter, we generally refer to 'loss adjuster', although we recognise this term may be used interchangeably with loss assessor or claims assessor in practice.

352 We note this includes all contractors engaged to rebuild buildings or conduct repairs. Where we use the term 'repair' or 'cost of repairs' we mean this to include 'building works' and 'cost of building works'. Where we use the term 'repairer' we also mean this to include 'builder'.

11.1 How do claims work?

An insurer's Product Disclosure Statement (PDS) will set out to a consumer how to make a claim. The PDS will explain, at a high level, how the insurer will assess a loss and how it may settle a claim. Importantly, it will also advise the consumer about what to do if they are not satisfied with an insurer's decision and how to make a complaint, including an internal and external dispute resolution process. This important information is generally provided at the commencement of a policy and not as comprehensively when a claim is made, in particular the consumer's right to access dispute resolution.

The Code sets the minimum standards for insurers to meet in handling claims. It sets timeframes around key steps, including in relation to notifying a consumer about any appointment of loss adjustors and determining whether a claim is payable. The Code also addresses standards relating to repairs and standards for service suppliers. The Code acknowledges that during times of 'catastrophe and disaster' large numbers of claims may prevent insurers from meeting all the prescribed standards. The Code is discussed further in section 11.5 of this chapter.

We set out below how an 'ideal claim' unfolds, from the initial lodgement of the claim to the settlement of the claim. The way in which each of these processes is conducted and the potential conflicts of interest between an insurer and other parties involved in a claim will be examined further, as well as how these processes can break down in the event of a natural disaster.

The 'ideal' claim

A claim is initiated by a consumer following an event that has caused damage to their home and/or contents. How an insurer responds to the initial lodgement depends on the estimated extent of damage and cost of remediation, the urgency of required repairs, and on whether further investigation of the claim is likely to be required.

Initially an insurer will attempt to determine if emergency, or 'make-safe', repairs are required in order to reduce the risk of any further damage and secure the property. If so, an insurer will generally arrange for a repairer to attend the property within one to two days to do emergency works such as applying a tarp to the roof to prevent further water ingress, or placing a security cordon across dangerous or open areas of the property to prevent access.

The insurer may then decide it is necessary to assess the claim. This will usually be by the appointment of a loss adjuster who attends the property to inspect the damage and reports back to the insurer with its views on if the claim should be accepted under the terms and conditions of the policy. The loss adjuster's advice, policy interpretation and proposal to cash settle or repair will set the path the rest of the claim will follow.

Should the claim proceed, the next step is to arrange for a repairer to prepare a full scope of works which itemises in detail the areas of damage and provides a cost for the repairs. Insurers typically operate a panel of preferred builders or repairers who, based on their contractual arrangements, will provide prices to the insurer (that may not be the same prices available to the general public). An insurer may also request the customer provide a secondary quote from its own repairer for comparison.

At this stage, an insurer will consider the cost of the repairs and the particularities of the claim and consider how to finalise the matter. This may be through a cash payment to the customer to the value of the repairs (a cash settlement), or the formal appointment of a repairer to undertake the repairs.

11.2 Assessing a claim and the role of loss adjusters

An insurer will typically appoint a loss adjuster to attend a property that is the subject of a claim and examine the cause and extent of the loss. The loss adjuster will then determine the scope of damages, consider this against any policy terms and limits that may apply, and report back to the insurer with its recommendations on how to proceed. Throughout the life of the claim, a loss adjuster may appoint repairers/builders or other experts to further investigate the cause of damage, and otherwise negotiate settlement between the insurers, repairers and customers. In other cases, they may pursue recovery from a third party for damages.

The Australian Institute of Chartered Loss Adjusters, a peak body representing the industry, describes the role of a loss adjuster as a 'bridge' between parties, being generally an insurer and a consumer.[353] As an intermediary, all decisions and communication between a consumer and insurer will generally pass through the loss adjuster. This can present problems if there are disagreements with the assessment or the progress of the claim and remove too much control or oversight from the insurer.

Members of the Code often and increasingly engage service suppliers (including investigators, loss assessors and adjusters, collection agents and claims management services) to conduct claims-related functions. Between 2015–16 (when the Code Committee began collecting data on this section of the general insurance workforce) and 2016–17, the number of service suppliers increased 36 per cent from 5777 to 7860.[354]

A loss adjuster is an agent of the insurer

Whether direct employees or outsourced contractors, loss adjusters are agents of the insurer. They are appointed to 'adjust' or minimise the total cost of a claim. They achieve this through their interpretation of the relevant PDS and how the conditions and limitations might apply and also through their role in negotiating how claims will proceed with respect to approved repairs.

Loss adjusters are paid by an insurer to decide what costs will be accepted in a claim, and what costs will not. They are under no obligation to advocate for the interests of the consumer.

How much they are paid will likely vary between loss adjusting companies and the particular insurer that they have entered into a contract with. Generally, however, we understand the fee received is commensurate with the size of the claim: the higher the cost of the claim, the higher the fee. This may be either through a percentage of the total cost of the claim, an hourly rate for service, or a fee structure that operates on a sliding scale.

A loss adjuster may also be acting under a Delegation of Authority from an insurer and be able to accept, authorise, or otherwise make claims decisions on behalf of the insurer without referral. This delegation is significant: information we obtained from insurers suggests this delegation could be for claims of up to $50 000. An important exception to this authority, however, is where a claim is to be denied. In these instances, a loss adjuster makes a 'recommendation' to the insurer who as the provider of the product must communicate denied claims to the consumer. In a submission to our inquiry, a building engineer highlighted its concerns with the apparent independence of loss assessors (see first item in box 11.1 below):

353 aicla.org/wp-content/uploads/career-pack.pdf.

354 General insurance in Australia 2016–17—*Industry practice and Code compliance Report*, p. 39.

Box 11.1 Extracts from submissions from local experts, residents and property owners

'One of the fundamental issues is that Loss Assessors, engineers and building consultants who are sent to these properties to make the damage assessments, effectively are working for the Insurers. The independence of their reports and assessments are questionable as on almost all occasions we have provided evidence in our reports that the assessments/conclusions reached, and the subsequent builder's Scope of Works, were flawed.'[355]

'In my job I meet with many people impacted by cyclones. The delays in assessors reporting or conflicting reports or very long times for the rebuild (with no ongoing support or checks from insurer) causes a great deal of stress for the occupants.'[356]

'There are huge disparities between the outcome claimants receive, as it depends on the assessor... There were people who had up to 3 roofs put on their house and it still leaked.'[357]

'I worked for an insurance assessor after cyclone Larry and was appalled by the managers decision making. If he didn't like the client he would advise the insurer not to payout and would report the property had insufficient drainage etc which majority of the time wouldn't have been the case. This assessor came from Brisbane into Townsville which he had no understanding of the suburbs drainage etc. I believe his decision making was unprofessional. He didn't even hold a builders license so was totally unqualified in my opinion.'[358]

The issue of the unclear status and independence of third-party experts such as loss adjusters have also been examined in previous inquiries. In its 2012 report on the *Operation of the Insurance Industry during Disaster Events* (Disaster Events report), the House of Representatives Standing Committee on Social Policy and Legal Affairs noted a common perception among communities that third parties employed by insurers may favour the insurers when issuing reports.'[359] In this report, Queensland MP Andrew Cripps summed up concerns regarding this issue:

> In many ways, the fate of the policy holders' claim is in the assessor's hands. Who are these assessors? What say does a policy holder have in the appointment of one to assess their claim? Can policy holders have confidence that they have the skills and experience to undertake an assessment of the damage to their property? Where and by who are they trained? Who regulates their profession?...What rights do policy holders have to seek a review of the assessor's report, or have another one done to verify it?[360]

We consider the issue of what information should be provided to a consumer at the outset of a claims process (including the role of loss adjusters) in section 11.3.

Denied and withdrawn claims

For the last financial year information obtained by the ACCC shows that the incidence of denial of home and/or contents insurance and strata insurance claims is approximately six per cent.[361]

Figure 11.1 shows the final claims decision and claims outstanding for claims lodged from 1 July 2017 to 30 June 2018.

355 Abscan Building Consultants supplementary submission, p. 1.

356 Submission from Anonymous 103.

357 Submission from Anonymous 132.

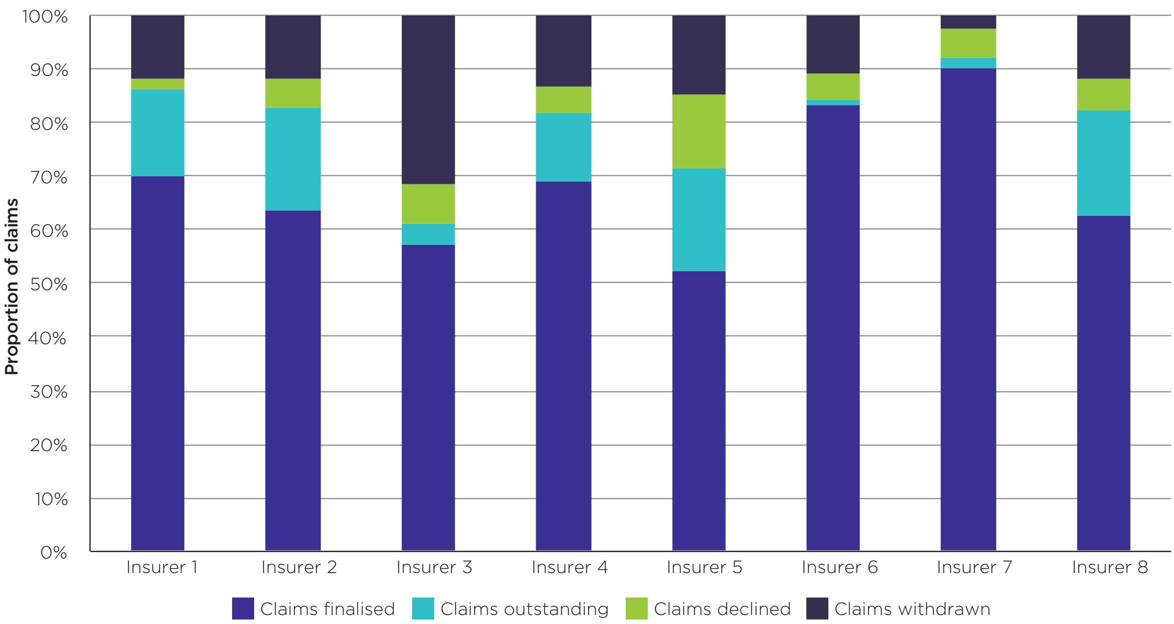
358 Submission from Anonymous 77.

359 House of Representatives Standing Committee on Social Policy and Legal Affairs, *In the Wake of Disaster, Volume One: The operation of the insurance industry during disaster events*, February 2012, p. 60.

360 Ibid, p. 61.

361 This is as a percentage of total claims lodged, less those where a claims decision is still outstanding.

Figure 11.1: Insurers' claims decision and claims outstanding for all lodged home and/or contents, strata insurance products nationally, 2017–18



Source: ACCC analysis of data obtained from insurers.

From data received there is little difference in the proportion of finalised, denied, and withdrawn claims in northern Australia compared to the rest of Australia. This suggests that an insurer's claim decision remains consistent regardless of geographic location.

There is an obvious variation in the percentage of claims outstanding for each insurer, with some having a significantly larger portion of claims that are ongoing as of 30 June 2018. This may indicate the timing of claims lodged within the last financial year or different settlement processes utilised by each insurer.

We note that the incidence of withdrawn claims is substantially higher than claims that have been denied by insurers, at approximately 12.5 per cent of all claims lodged (excluding claims still outstanding) within the last financial year. This demonstrates that consumer understanding of their product coverage needs to be improved. This is consistent with findings in previous chapters regarding consumer understanding. We also recognise that this data may also demonstrate consumers withdrawing claims if advised by an insurer that they are likely to be denied, in order to avoid the future negative effects of having had a claim denied (which could include a premium loading, or being denied coverage altogether). For one insurer the percentage of withdrawn claims is approximately 32 per cent of all claims lodged with them (excluding claims still outstanding) over the same period.

We acknowledge some limitations in the data, in particular as it relates to partially accepted claims or whether the withdrawal was initiated by the consumer or the insurer. However, irrespective of this the prevalence of withdrawn claims is of concern. This indicates there may be problems with this particular insurer's communication and information provided about product terms and conditions and claims assessment.

11.3 Settling a claim

Insurers' claims handling was a significant focus of our public consultation. Local residents and property owners across northern Australia shared some examples of their satisfaction with their insurer, but also many examples of where their experiences fell well below what they thought reasonable to expect. For example, local residents spoke of lengthy delays in claims settlement, unsatisfactory standards of work and pressure to accept an insufficient cash settlement.

Currently, 'handling insurance claims' is explicitly excluded from the definition of a financial service in the Corporations Regulations 2001. This means that ASIC's powers under the *Corporations Act 2001* (Cth) generally do not apply to claims handling.

In 2016, ASIC undertook a review of claims handing in the life insurance industry. Among its recommendations, ASIC called for the regulatory framework for claims handling to be strengthened by removing the current exemption and that more significant penalties for misconduct in relation to insurance claims handling also be considered.[362]

It was suggested that removing the exemption for claims handing would allow ASIC to take action on insurers' conduct, for example in relation to unnecessary or extensive delays in handling claims and incentive schemes for claims staff that conflict with the insurer's obligation to assess each claim on its merit. In releasing the report, the government announced it would ask Treasury to proceed with this recommendation and undertake targeted consultation on the merits of removing the exemption for claims handling practices.[363] This work is now on hold pending the conclusion of the Royal Commission.[364]

Insurers have discretion to determine how a claim will be settled

Insurers typically retain discretion to decide how a claim is settled. This will be communicated to a consumer in the relevant PDS (see example in box 11.2 below).

Box 11.2 Example of discretion to settle a claim[365]

We choose how we settle home claims.

If we agree to pay a claim for loss, theft or damage to your home, we will decide if we will:

- repair damage to your home;
- rebuild your home;
- pay you what it would cost us to repair or rebuild your home;
- pay you the sum insured for your home.

We choose how we settle contents claims.

If we agree to pay a claim for loss, theft or damage to your contents (including contents with flexible limits and personal valuables), we will decide if we will:

- repair damage to the contents;
- replace the contents 'new for old';
- pay you what it would cost us to repair or replace your contents or any lower limit that applies.
- pay you the sum insured for your contents or any lower limit that applies.

362 See ASIC report 498, *Life insurance claims: An industry review*, October 2016.

363 See kmo.ministers.treasury.gov.au/media-release/092-2016/.

364 See Treasury Background Paper 27: Reforms to general and life insurance, prepared for the Financial Services Royal Commission.

365 This example is from the Suncorp home and contents insurance PDS, prepared 19 October 2012, accessed 27 November 2018, p. 69 but it is broadly the same as equivalent clauses in the PDS of other insurers.

This discretion is potentially very significant at the time of making a claim but may be easily overlooked by a consumer at the time of taking out an insurance policy.

Information sought from insurers revealed that most insurers do not have a 'formal policy' governing the decision whether to settle with a cash payment or by repair/rebuild, rather it is generally considered on a case by case basis.

Insurers did advise that there are particular circumstances or factors they will take into account in a decision to provide a cash settlement, such as:

- when it is specifically requested by the customer
- where repairs have already commenced or been conducted
- where there is only partial acceptance of the claim due to respective policy exclusions, such as in the case of lack of maintenance or wear and tear
- part of the loss or damage is not indemnifiable under the policy
- if the item cannot be replaced/repaired
- where the cost exceeds the policy, sum insured or applicable item limit.

Most insurers submitted that they generally had a preference to repair or rebuild as a means of settling claims but data obtained by the ACCC indicates that insurers in fact often make cash settlements.

The data provided by insurers also confirms that the majority of claims are currently being finalised by way of cash settlement to consumers.[366] There do not appear to be significant differences in the approach taken between northern Australia and the rest of the country, as shown in figure 11.2.

Where claims were not finalised with cash settlements, but rather through repair work paid for by the insurer, this work was carried out by the insurers own repair network in most cases. Consumers used their own repairers with the agreement of (and reimbursement from) insurers in approximately two per cent of all home building cases.

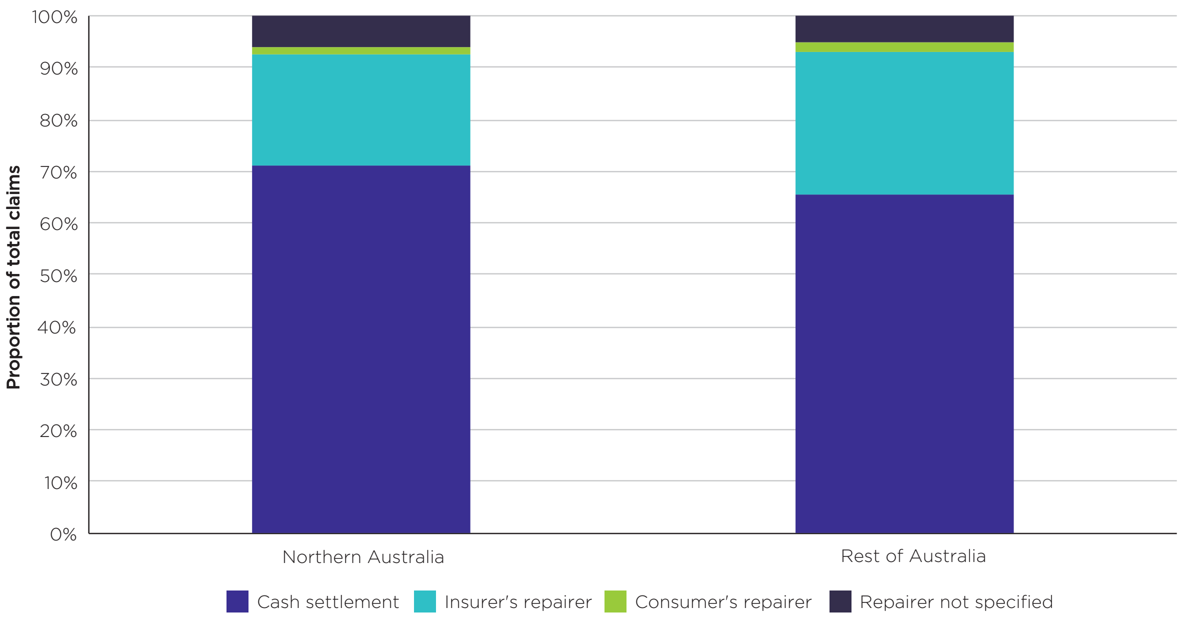
366 Insurers varied in relation to how they categorised claims, particularly those that were settled by a combination of both cash and payment to a supplier/repairer. This included categorising settlement in relation to the dominant payment type, categorising cash settlement where 85 per cent or more of the claim was paid in cash or categorising cash settlements only where the entire claim was cash settled. Some insurers were unable to differentiate for building and home contents insurance between payments to panel repairers or non-panel repairers. As such, for figures 11.2 and 11.3 these have been grouped into a separate category labelled 'repairer not specified'. One insurer reported all payments to a consumer's repairer as cash settlements, however the effect of this approach on the overall figures is expected to be minor.

Figure 11.2: Proportion of claim settlement options used by insurers for home (building) insurance, 2017–18

Source: ACCC analysis of data obtained from insurers.

Figure 11.3 shows that over 65 per cent of all contents claims nationally were finalised by cash settlement. From contracts obtained, we note that some insurers will enter into panel agreements with suppliers of consumer electrical goods, hardware and tools, jewellery and furniture. These suppliers function in much the same way as an insurer's building panel and will supply replacements of damaged contents at preferential rates.

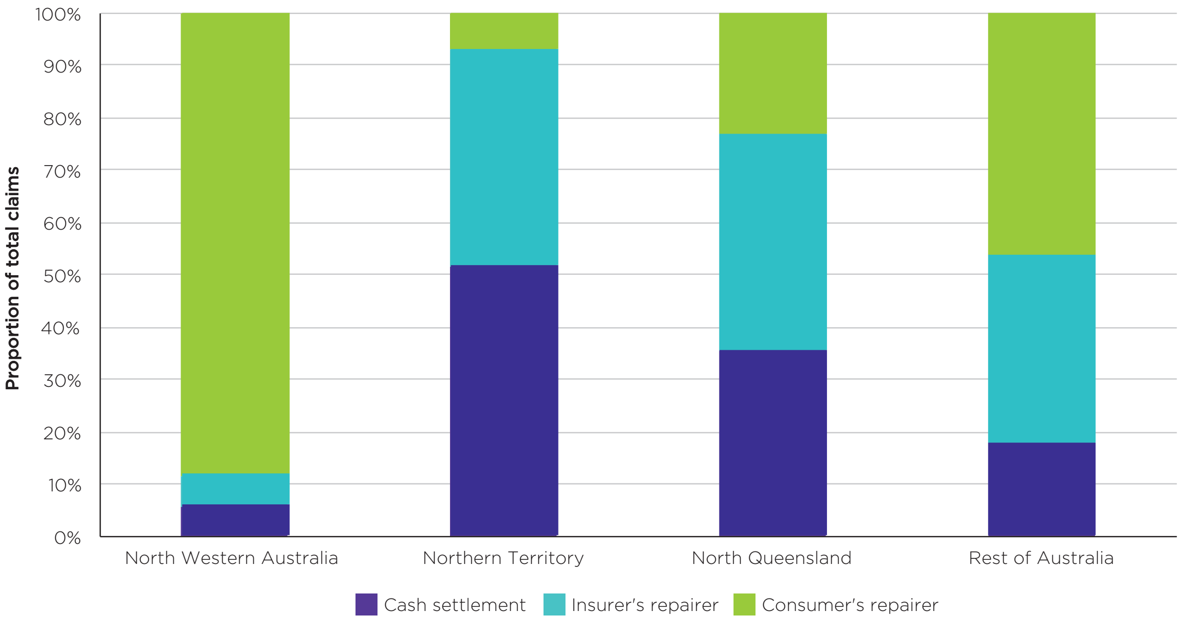
Figure 11.3: Proportion of claim settlement options used by insurers for contents insurance, 2017–18



Source: ACCC analysis of data obtained from insurers.

As noted in figure 11.4 regarding strata, in north Western Australia there appears to be a preference for insurers to reimburse a body corporate for their own repair or replacement costs, and that both cash settlement and appointment of an insurer's panel repairer are marginal. The remoteness of communities in the north of Western Australia is likely to mean insurers' repair networks have a limited presence there. We also acknowledge the sample size for north Western Australia over the 2017–18 period is relatively small.

Figure 11.4: Proportion of settlement options used by insurers for strata insurance, 2017–18



Source: ACCC analysis of data obtained from insurers.

Cash settlements

Cash settlements can facilitate a swift resolution of a claim and allow consumers to undertake (their own) repairs or a rebuild more quickly and with more autonomy. It could also provide more flexibility to consumers to relocate or redesign their home.

Some property owners in northern Australia indicated to us that this was, or would be, their preference in the event of a claim for total loss of their home.

Despite offering some appeal to some consumers, various stakeholder groups continue to highlight their concerns with the way in which insurers use cash payments to settle claims.

Insurers may determine the amount of a proposed cash settlement with reference to what it would cost them (the insurer) to repair or rebuild the property, based on trade discounts and agreements with panel tradespersons. This may differ significantly from the costs consumers would face to rebuild or repair their homes and could leave them out of pocket.

In its submission to our inquiry, the Financial Ombudsman Service (FOS) set out observations based on its experience in resolving general insurance disputes. FOS advised as follows in relation to the adverse outcomes that can arise for consumers though the overuse of cash settlements by an insurer:

- The cash settlement amount may be insufficient because it is based on quotes provided by the insurer's panel builders, which include volume discounts and rebates.
- Consumers may be required to manage complex repairs projects where they do not have the knowledge and experience required to do so.
- Consumers are deprived of the lifetime guarantee available where repairs are completed by the insurer's contractors and therefore bear the risk of any subsequent problems.[367]

367 Financial Ombudsman Service submission, p. 8.

Cash settlements were also raised in the context of concerns about an imbalance of power between insurers and consumers and used as an example of a potential unfair contract term. We discuss these issues in chapter 8. The FOS also provided an example of a dispute highlighting this.

Box 11.3 FOS Dispute 419147—cash settlement unfair outcome for customer[368]

FOS Dispute 419147 related to damage caused by a tropical cyclone in February 2015. In FOS' determination they concluded that the cash settlement offered by the insurer was not fair because it transferred all the risk to the consumer, did not make sufficient allowance for possible variations which could be required as part of the building works, and did not adequately provide for temporary accommodation costs.

Across our public forums we heard people say that cash settlements offered were not enough and conversely insurers were inclined to directly accept quotes from repairers that consumers felt were too high or thought could be done for less by local contractors.

Settling a claim by rebuilding or repairing

At a time of distress and vulnerability, some consumers might have a stronger preference for insurers to case manage a repair or rebuild, including engaging and guaranteeing the tradespeople and their work.

Tradespeople and quality of work

Information we obtained from insurers suggests most generally have a preference to engage a builder/repairer from their panel. This can allow the insurer to authorise repairs more swiftly, achieve cost and time efficiencies, and guarantee both the quality standards of the repairs.

However this is not always the case, with some insurers more willing to engage local trades. One insurer noted that all of the preferred repairers that service northern Australia have offices or satellite offices in the area with local supervisors and/or estimators. Where possible, these repairers use local licenced trades to complete repairs who typically have a better understanding of local building codes, the local area, and building characteristics such as average building age, construction type and roofing materials.

Another insurer also stated that it has designed its supply panel to ensure that it can support the local trade industry. A number of insurers also noted that selection criteria for their panel tradespeople are based on categories including regional coverage and provides that repair networks can be supplemented by local repairers during times of high demand.

Who undertook the repairs was a theme raised by a number of property owners in northern Australia. Some expressed frustration with the lack of preference given by insurers to local tradespeople. One of the particular concerns local residents raised was that insurers favoured more expensive quotes from non-local repairers who may have less awareness of local conditions and provide lesser quality outcomes.

This concern is supported by an earlier 2011 report published by James Cook University, *Tropical Cyclone Yasi structural damage to buildings,* which reported that repairs conducted by builders from within the cyclone region may have had higher success in withstanding a cyclone than those from outside of the region.[369]

Legal Aid Queensland (LAQ) submitted that builders and consumers reported instances of insurers selecting quotes far more expensive than those that have been given by other builders for works of similar scope.[370] This is also discussed further below.

Residents of north Queensland also discussed poor quality repairs through the online survey. Some examples are in box 11.4 below.

368 Ibid, p. 9.

369 James Cook University, Tropical Cyclone Yasi structural damage to buildings, CTS Technical Report No 57, April 2011, p. 31.

370 Legal Aid Queensland submission, p. 3.

Box 11.4 Extracts from submissions from local residents and property owners

'We have helped people crying, unable to manage the process that requires forms, ongoing correspondence and management of a complex process. The most serious have involved customer claims handled by the insurer, engaging construction services and builders that were not qualified, were over-paid and delivered faulty work. In some cases there were building surveyors, engineers and builders from outside the area causing most of the problems. We are still engaged with a cyclone damaged house in Cardwell that is on to its 2nd builder with a QBCC claim and now a QCAT claim for work from 2012.'[371]

'...I thought I had escalated 3 times only to be told 5 months later that I hadn't escalated at all! 11 week delay to get the mould in my house checked and assessed in my house (Family very sick requiring hospitalisation!) 17 weeks to carry out mould testing, mould then taking over my house and causing more damage to my house and contents. Insurance Companies employing contractors that are either not qualified or experienced to give expert reports. 17 weeks to get the house reassessed (phone calls every week).' [372]

'...We have had three questionable engineering reports and one unsatisfactory roofing report to refute, before finally being granted a new roof a few months ago. Now the panel builder has ignored the scope of works which required an engineer to be engaged to determine the wind rating, tie downs and upgrade. I have had to fight for this happen so now holding up the roof, when I requested the copy of the engineering report some time ago. It appears that the roof was going to go on without abiding by the code which required this to happen...We also had to refute a questionable flooring report by a mate of the assessors and the engineers that we had, all seem to be in relationships with the panel builders and insurance company. We had a similar experience with the claim for the other house...[The insurer] has spent thousands on these questionable reports to reduce our claim and could have put that money to fixing the damage. This has also caused considerable delays to the resolution of the claims and affected our health.'[373]

371 Submission from E. Thirkell.

372 Submission from M. Gray.

373 Submission from Anonymous 132.

FOS also noted in its submission:

> In areas where extreme weather events occur, buildings need to meet additional requirements. Repairs in those areas, which may present additional difficulties, have been the subject of disputes considered by FOS.
>
> The ongoing exposure of properties to severe weather events means that inadequate repairs may result in significant additional damage. [374]

FOS provided an example of this set out in box 11.5.

Box 11.5 FOS Example Cyclone Oswald—inadequate repairs[375]

FOS Dispute 458054 related to property damage caused by Cyclone Oswald. Our Determination found that the insurer's repairers failed to adequately rectify moisture issues caused by the storm, which resulted in the proliferation of mould throughout the property.

Managing contracts with panel repairers

We conducted a review of panel repairer/builder contracts obtained through the inquiry. These proved to be very comprehensive designed to minimise cost and obtain value for the insurer. They imposed high service standards and contained a series of performance measures and indicators that repairers were required to adhere to. These included average repair costs, customer satisfaction, claim cycle time, quote cycle times etc. The contracts also provided for regular performance reviews and capability to conduct audits to ensure repairers were adhering to their contract terms. Insurers were generally able to terminate contracts at their discretion.

It was not clear to what extent performance reviews actually take place and how a repairer's delivery of the contract terms is managed in practice, including by removing a repairer from a panel. Internal documents obtained from insurers also indicated that periodic discussions do take place (although they did not indicate how often), however repairers may still over quote, with insurers seeking to negotiate and lower costs.

An email obtained by this inquiry from one insurer sheds some light on the internal process regarding selection and management of panel repairers and how they may still attempt to over quote.

Box 11.6 Extracts from internal email

'..I had to share this one – this claim was in far North Queensland – a storm claim impact from tree...
Original quote $75K
Second tender $44K
Third tender and awarded – we waited until the repairs were completed at a cost of $10,594.
A saving of nearly $65K!!'
...
[Home Assessing Manager]

'...Thought you would get a laugh out of this.
I'm surprised this particular builder [builder name] isn't removed from our [insurer name] panel. It seems we pick and choose who can or can't quote excessively and get away with it.'
[Procurement Manager]

'One for you to take up with them [the builder] in your periodic discussions..'

Some submissions indicated that the agreements between builders/repairers and insurers are not working as intended to minimise costs, with LAQ noting that:

374 Financial Ombudsman Service submission, p. 8.

375 Ibid.

> While a number of factors affect insurance costs, consumers are reporting to LAQ that repair costs are well above ordinary market rates. While increased demand for building and repair services naturally rises after a damaging event and it is expected prices may reflect this relative scarcity, many consumers feel they are being gouged by tradesman to complete repairs.
>
> This is recognised by insurers who have established panels, preferred suppliers, multiple quotes and other mechanisms to obtain value from repairers. However, LAQ is informed these mechanisms are not working as intended to minimise repair costs. Builders and consumers have reported that insurers have selected quotes far more expensive than those that have been given by other builders for works of similar scope. This apparent choice of inferior quotes is affecting confidence in the insurance market.[376]

The need to appropriately manage building and repair costs for insurers is arguably even more important in northern Australia. The Insurance Council of Australia (ICA) submitted that rebuilding costs in the region are up to 42 per cent higher than in the south.[377] Our own analysis based on 2017 costs suggests that, within northern Australia, northern Western Australia has the highest average rebuild costs ($619 378) compared to northern Queensland ($559 122) and the Northern Territory ($581 695) for a standard property.

High rebuilding and repair costs in northern Australia is also considered in chapter 4, and the impact this has on premiums is considered in chapter 5.

Catastrophe and disaster arrangements

Information we obtained from insurers suggests that most provide explicit acknowledgment of catastrophes/major events in their arrangements with suppliers and how these should be managed to optimise service delivery. Different service standards and fees are also applied by most insurers to suppliers servicing rural areas and/or responding to catastrophe events.

In information we obtained specifically about insurers' composition and operation of any building repair network, some insurers made reference to how they manage catastrophes. This includes ensuring builders/repairers have the capability to increase their resources from within their state and nationally and are able to respond to large scale catastrophe events within hours, and panel design ensures that it can support the local trade industry to provide a relative response for its customers during peak events.

Consumer understanding of the claims process

Insurers will generally provide varying amounts of information to a consumer when they make a claim. This may include the steps to be undertaken in assessing and settling the claim, including a link to or copy of their PDS. Only limited information seems to be provided on how they make a decision, appoint a repairer, agree to settle a claim and reinforcing the consumer's access to dispute resolution should they be dissatisfied with a claim outcome.

The Code does not specifically outline what information an insurer must provide to a consumer when lodging a claim. It only advises the following in relation to making a claim:

- a consumer is entitled to ask if its insurance policy covers a particular loss before a claim is lodged
- if a consumer makes a claim and the insurer does not require further information, assessment or investigation, it will decide to accept or deny the claim and notify the consumer of their decision within ten business days of receiving the claim
- if the consumer makes a claim and the insurer requires further information or assessment, within ten business days of receiving the claim, the insurer will:
  - notify the consumer of any information it requires to make a decision
  - if necessary, appoint a loss assessor or loss adjuster, and
  - provide an initial estimate of the timetable and process for making a decision on the claim.[378]

376 Legal Aid Queensland submission, p. 3.

377 ICA submission, p. 14.

378 See 7.8–7.10 of the General Insurance Code of Practice.

We note that the Code has recently been reviewed and the final report issued in June 2018. It recommended that when a claim is made, insurers should be required to provide the customer with an overview of the claim process, along with any excesses, waiting periods and contact details to get information about their claim.

The ICA noted in the report that it supports the claims process being more transparent, timely and easier to navigate, to aid consumer understanding about what can be an unfamiliar process.[379] We support this recommendation but believe it falls short of what a consumer should be told at the outset of a claims process.

Recommendation 12: Better information for consumers lodging a claim

The General Insurance Code of Practice should be amended to require that at the time a consumer lodges a claim, an insurer or its agent must clearly inform the consumer of the insurer's claim handling policy, and expressly refer to:

- **how the insurer will assess the validity of the consumer's claim**
- **the insurer's preferred repairer policy and in what circumstances a consumer can use their preferred repairer**
- **how decisions are made on cash settlements**
- **who will be managing the claim (for example, the name and contact details of a contracted claims company if relevant)**
- **the fact that the loss adjuster is acting on behalf of the insurer and not the consumer**
- **the consumer's right to make a complaint to the insurer and the Australian Financial Complaints Authority.**

Giving consumers a greater say in how their claim is settled

Stakeholders have raised concerns with the potential for cash settlements to leave consumers worse off. This concern arises not from cash settlements per se, rather when it is against the consumer's wishes to accept a cash settlement and/or when the amount offered is perceived as being inadequate for a consumer to repair or rebuild its property.

There is currently no express requirement for an insurer to take into consideration a consumer's preferences in making its decision about how to settle a consumer's claim. We propose that consumers must be given the right to make this decision. That is, the consumer can either require the insurer to rebuild or repair the property or choose to take a cash settlement based on what it would cost the insurer to undertake the work.

Cash settlements provide more flexibility for consumers, for example to relocate, renovate, modernise, down-size. It also allows them to engage the tradespeople of their choice (for example local people if this is important). But they are also inherently more risky for consumers as they must assume responsibility for overseeing any work they choose to undertake. These advantages and risks are present regardless of which party makes the decision about settlement—just currently the allocation of risk is at the discretion of the insurer.

Should a consumer opt for a cash settlement, the appropriate amount would generally be the lowest price quoted to the insurer. This amount may reflect discounts or rebates provided to the insurer by a panel tradesperson which would not be available to a consumer using that tradesperson. However, a consumer opting for a cash settlement would not be limited to using one of the tradespersons that had provided a quote to the insurer. Instead, it could compare the proposed cash settlement amount with quotes it has obtained from other tradespersons. In contrast with current arrangements, if the consumer could not procure the repair work at a cheaper rate than the insurer could, it can choose not to settle a claim by way of a cash settlement.

Cash settlement amounts may also need to be adjusted to reflect work already undertaken, part of a claim is not accepted due to exclusions and other policy limits, and the overall sum insured. We note

379 ICA Review of the General Insurance Code of Practice Final Report, June 2018, p. 58.

such adjustments are already made in situations where an insurer opts for a cash settlement. There may also be circumstances where a rebuild or repair is not practicable (for example, rebuilding in area now rezoned or unsafe for development or wear and tear).

Consumers will be more likely to opt for a cash settlement in situations where the insurer's preferred quote amount for the necessary works is relatively high. In such cases, a consumer opting for a cash settlement could separately commission the work for a lower cost and retain the difference. This approach will not leave insurers any worse off financially (as they would have incurred the same cost had the consumer opted against a cash settlement).

Further, this approach would add a layer of pricing discipline on tradespeople providing quotes to insurers (including those on their panel) as they would need to quote knowing that, even if their quote was the lowest received by the insurer, if it was substantially higher than competitive rates, the consumer could opt for a cash settlement and then engage a different supplier.

Draft recommendation 11: Giving consumers more control over how claims are settled

The Insurance Contracts Act should be amended to provide consumers with the right to choose whether their home insurance claim is settled through a cash settlement or by proceeding with a repair/rebuild managed by the insurer.

The consumer must be given clear notice of the implications of accepting a cash settlement, for example the insurer will be discharged of any obligations to manage or guarantee the quality, cost or timeliness of any repair the consumer chooses to undertake. Any ancillary expenses subject to the claim that are not within the scope of works for the quote (such as temporary accommodation costs) would be settled separately.

11.4 Delays in claims handling a cause for concern

Delays may occur at different stages of the claims process. This includes:

- deciding whether to accept or decline the claim
- damage assessment whether as part of the initial assessment in deciding whether to accept the claim or as part of determining the extent of the damage
- the time taken to finalise the accepted claims, whether by way of cash settlement, replacement or repair.

Insurers' obligations to settle claims in a timely manner

The Code requires its members to handle claims in 'a fair, transparent and timely manner' and sets out particular timeframes for the management of claims.[380]

The Code establishes minimum standards for insurers to meet in handling claims and complaints. It sets timeframes in which insurers will appoint loss assessors, requires insurers to give policy-holders updates as to the progress of their claims and respond to policy-holders' requests for information. In addition, there is a 10-day time limit under which the insurer needs to provide a decision on claims. This is either from the day that the claim is lodged (assuming no further investigation is required), or otherwise from the time that an insurer receives all necessary information and investigations are completed.[381] These timeframes can be varied by mutual agreement between an insurer and its customer.

The Code also has a separate section on catastrophes, which stipulates insurers will respond to Catastrophes in an efficient, professional and practical way, and in a compassionate manner. It also advises that where a consumer has a property claim resulting from a Catastrophe and is within one month after the Catastrophe event causing loss, the consumer can request a review of where it thinks

380 Section 7 of the General Insurance Code of Practice.

381 Section 7.16 of the General Insurance Code of Practice.

the assessment of loss was not complete or accurate. The consumer will have 12 months from the date of finalisation to ask for a review.

Claims delays during times of catastrophe

During times of natural disaster, the number of claims will increase, as will the workload of insurers, increasing the likelihood of delays.

Several previous reviews have considered claims delays during times of natural disasters and catastrophes. In 2012, the Disaster Events report outlined that it 'received overwhelming evidence that insurers often failed abysmally to meet the timeframes in the aftermath of recent natural disasters...'[382] It made a number of observations, including that:

- in many instances, insurers did not meet the timeframes contained in the Code when responding to the large volumes of claims arising from natural disasters
- many consumers were subject to unreasonable delays in the assessment of their claims
- the widespread use of third parties by insurers added to the delay, as both insurers and consumers had to wait for their assessment
- even where claims had been resolved and insurers had accepted liability, they faced further delays with third parties contracted for the repair or rebuild.[383]

Local residents and property owners across northern Australia shared many examples of claims processes that fell below their expectations, particularly in relation to delays and lengthy claim processes. It was evident to us that these delays were causing property owners a high degree of frustration and further distress at an already difficult time. In some cases, property owners considered the delays were causing even more damage to their property. Several examples are included in box 11.7 below.

382 House of Representatives Standing Committee on Social Policy and Legal Affairs, *In the Wake of Disaster, Volume One: The operation of the insurance industry during disaster events*, February 2012, p. 55.

383 Ibid, pp. 52–54.

Box 11.7 Extracts from submissions from local residents and property owners

'I'm aware in the Whitsundays that we've multiple properties that've had tremendous problems with their claims and scope of works. 7 months after TC Debbie and some work hasn't even started! However, on the other side, I've found people with ISR policies where not only is a broker involved but also a risk assessor and a risk management company and they've had very little trouble.'[384]

'We are covered for everything but getting our house repaired from Cyclone Debbie is a nightmare! [Insurer name] are playing the 'maintenance' card and delaying claims. We have now employed someone to take care of our claim and we are finally getting some traction. Our claim has now been escalated and we are finally being treated professionally and with respect. The way we have been treated over the last 7 months has been disgraceful. I have been bullied and intimated. Our new higher ranking [insurer name] Assessor has apologised and is now trying to do the right thing. We still have a way to go but it's definitely more positive.'[385]

'Oh my, the treatment of the people here in Airlie Beach from the insurers is disgraceful! I pay about $3 300.00 insurance per year for our principal place of residence. The home is insured for $650 000.00 and 7 months on I've had no work agreed upon, let alone started. I've been bullied and intimidated by [insurer name] and their panel builder ganging up against me...Not to mention that we are now heading into cyclone season with very broken homes and have had your live in them like this for 7 months. It's sad and depressing for many.'[386]

'...Now the work has commenced, it is of a terrible standard. At one house, the painting and patching is just that and is a disgrace. The polished floor..also has problems and it is another cowboy contractor. It has been a nightmare for 9 months, almost being a full time job, and we ended just signing the contract to get the work started despite it not being correct...'[387]

Timelines can be stretched in the case of a natural disaster or other large event where many people in the same area are affected, this increased demand for labour and material resources may even leave a consumer with a considerable delay between the event and make-safe repairs being completed.

The 2012 Disaster Events report found that:

> The general insurance industry maintains that Australia is not able to meet the demand for tradespeople that occurs after natural disasters of such magnitude and scale as the recent extreme weather events. Suncorp Group admits that 'the main issue has been the availability of these services in the context of extensive damage over a wide geographical area and the shortage of skilled workers. This has unfortunately led to some delays'.[388]

The National Insurance Brokers Association (NIBA) claims that:

> ...there are simply not enough resources in the building and related trades and in other material suppliers to allow insurers to provide what might be regarded as a normal response within normal time frames when you have so many claims happening and so much damage occurring all at the same time.[389]

We acknowledge the difficulties insurers face when large catastrophes occur. In particular, insurers face a challenging task in balancing the competing needs of making timely repairs and containing repair costs.

384 M. Shaw submission, p. 10.

385 Submission from Anonymous 26.

386 Ibid.

387 Submission from Anonymous 132.

388 House of Representatives Standing Committee on Social Policy and Legal Affairs, *In the Wake of Disasters, Volume One: The operation of the insurance industry during disaster events*, February 2012, p. 60.

389 Mr Dallas Booth, Chief Executive Officer, National Insurance Brokers Association (NIBA), Committee Hansard, Sydney, 14 October 2011, p. 2.

In some cases, deferring non-critical repairs or rebuilds could result in significant cost savings, however this should be at the discretion of the consumer. Draft recommendation 11 above would provide consumers with this opportunity by opting for a cash settlement now and then undertaking the repairs at a later time.

11.5 Complaints and dispute resolution

Local residents and property owners who participated in public consultation often spoke about the importance of an insurer's customer service, reputation, claims handling and dispute resolution processes. They also spoke about their concerns with delays in resolving claims, in particular getting their damage assessed and waiting for repairs to be completed. At times, people were highly critical, with some claiming they (or others) had been bullied, intimidated and subjected to unethical practices by their insurer.

While our public consultation suggested that consumers generally had firm expectations of the standards they expected from insurers when it came to managing their claim, it did not demonstrate to us that local residents had a high level of awareness of their right to escalate a complaint to an external dispute resolution (EDR) service.

This process will be set out in a PDS, but we have concerns about how consumers are reminded about this process at other times. See recommendation 12 above.

Insurers must have formal dispute resolution processes

All insurers with an Australia Financial Services License (AFSL) must have an Internal Dispute Resolution (IDR) process.[390] The Code also sets out the IDR process that signatories to the Code must follow (detailed in the IDR section below) and should be consistent with the obligations contained in ASIC Guide 165. The Code is however voluntary and self-regulated by the industry. The Code Governance Committee (CGC) is the independent body that monitors and enforces insurers' compliance with the Code. The CGC outsources its day-to-day Code compliance monitoring work to the AFCA Code Compliance and Monitoring team, which provides code monitoring, secretariat and administrative services.

All insurers with an AFSL must also be a member of the new Australian Financial Complaints Authority (AFCA), which absorbed the functions of the former FOS as of 1 November 2018.[391]

AFCA is the only approved EDR scheme for general insurers in Australia and is free for consumers to access. Consumers have a right to make a complaint with AFCA when they have been unable to successfully resolve a complaint with their insurer (detailed in the EDR section below). AFCA will consider the Code when making a decision, but will not necessarily be bound by the minimum standard set in the Code if they believe the insurer should have met a higher standard.[392]

IDR—lodging a dispute with an insurer

The Code commits insurers to resolve a dispute within 45 calendar days in total of a dispute being lodged.

The Code outlines the different protocols between IDR and EDR processes. Under the Code, an IDR is a two-stage process that requires insurers to:

- respond to a complaint within 15 business days of the date of receipt, provided they have all necessary information and have completed any investigation required
- keep the consumer informed about the progress at least every ten business days, unless the customer agrees otherwise

390 Under the *Corporations Act 2001* (Cth), if you hold an AFSL you must have an internal dispute resolution system that meets the standards set out by ASIC (see ASIC Guide 165).

391 The requirement to be a member of an EDR scheme is also contained in the *Corporations Act 2001* (Cth).

392 See www.afca.org.au/what-to-expect/how-we-make-decisions/

- respond to the complaint in writing, outlining:
  - decision in relation to the complaint
  - reasons for the decision
  - consumers' right to take the complaint to stage two of the Code IDR complaint, if the decision at stage one does not resolve the complaint
  - if the consumer is still not satisfied with the decision after stage two, their right to take the complaint to AFCA, together with contact details and the timeframe within which the consumer must take the Complaint to the AFCA
- advise the consumer where they are unable to provide a final decision within 45 days (this is the date the insurer first received the complaint and commenced stage one of the process), including the reasons for the delay and the consumers right to take the complaint to AFCA together with AFCA contact details.[393]

Although the Code was amended in 2014 to incorporate additional requirements regarding the complaints process, there is still no explicit requirement in the Code for an insurer to notify a consumer of its IDR process when a claim is lodged. This is despite this limitation being observed several years earlier in the 2012 Disaster Events report.[394]

We are concerned that this anomaly may contribute to a low level of consumer awareness about their options for escalating complaints.

In its submission to the interim report of the 2017 review of the Code, FOS submitted that it has seen examples where a complainant has not been informed at stage one of the two-stage process of either the 45 day IDR period or the right to pursue the matter through EDR. FOS argued that if a two-stage process is to remain, then at the very least a complainant must be informed at stage one of the 45 day IDR period and the right to pursue the matter through EDR.[395]

As part of the 2017 review of the Code, the ICA considered consumer submissions that the two-stage complaints system is too long, difficult and confusing (particularly for consumers experiencing vulnerability due to a claim), and many consumers are unaware of 'what to do at a particular point'.[396]

The ICA considered concerns raised and recommendations to amend the Code and the complaints process. In the 2017 Review of the General Insurance Code of Practice Final Report, it was recommended that where an insurer is unable to make a decision on a claim within 45 days that this is provided in writing. The ICA proposed to continue to work with insurers to determine other suitable changes to the two-stage complaints process. It noted that it did not propose to change the complaints process due to the substantial systems changes and costs involved. In addition, with the transition to AFCA, they are aware that ASIC will be consulting on RG 165, which may affect regulatory requirements around complaints handling. We encourage the ICA to work with insurers and ASIC to consider whether alternatives or modifications to the two-stage process could make IDR processes less confusing and more timely for consumers.

Further to the above we note that importantly, the recommendations regarding dispute resolution, do not go in to the issue of increasing consumer awareness of the complaints processes.

EDR—lodging a dispute with the AFCA

Feedback from our public consultation highlighted the anxiety and distress that consumers are experiencing and their inability to resolve situations of concern effectively with insurers. Notably absent was a demonstrated awareness of how to escalate their complaint to FOS (as it was at the time).

393 General Insurance Code of Practice, ss. 10.11–10.18.

394 See House of Representatives Standing Committee on Social Policy and Legal Affairs, *In the Wake of Disaster, Volume One: The operation of the insurance industry during disaster events*, February 2012, p. 80.

395 Financial Ombudsman Service submission to the General Insurance Code of Practice Interim Report on review, April 2018, p. 19.

396 Review of the General Insurance Code of Practice Final Report, June 2018, p. 65.

If a consumer cannot resolve their complaint with their insurer, the consumer can escalate the complaint to the AFCA (in the same way a consumer could previously escalate their complaint to the FOS). There are some limits on the types of complaints the AFCA can consider and the compensation it can award:

- the dispute is a type it can consider (this includes home, contents and residential strata title insurance)
- the total claim is for $1 000 000 or less, however each individual claim cannot exceed $500 000
- any compensation claim is for $500 000 or less
- any compensation claim for general insurance broker disputes is for $250 000 or less.

An important distinction is that AFCA takes the view that the expression 'claim' refers to the set of facts that determines the dispute and is not strictly related to [the] insurance definition of 'claim'. If there are separate events or separate facts that lead to losses, the above limits and caps can be applied to each set of facts or 'claims' made by the consumer. For example, in the conduct of an insurance claim, a consumer may have separate issues that arise such as insufficient temporary accommodation costs, concerns of inadequate repairs, issues with the cash settlement amount etc., each of which can have a total monetary claim limit of $1 000 000, and potential compensatory limits of $500 000. We are concerned that the monetary limits and compensation caps may be inadequate for some claims raised by consumers, particular those that have experienced a total loss, and it will be important for these limits to be reviewed regularly.

If a dispute is not resolved by agreement, then AFCA will issue a determination which is binding on the insurer. This cannot be appealed but the consumer can choose whether to accept the determination.

The use of external dispute resolution providers, such as AFCA, appears to increase substantially following a natural disaster. The data available from FOS (the organisation with dispute resolution functions at the time), shows that in the years following Cyclone Yasi and the Queensland floods, the number of disputes relating to home and contents insurance rose from 5257 in 2010–11 to 7141 in 2011–12 and 7065 in 2012–13. This represents an increase of over 35 per cent in the number of disputes considered by FOS. This effect was also evident following Cyclone Debbie, where the number of disputes relating to home and contents insurance rose from 6411 in 2015–16 to 8094 in 2016–17, an increase of 26 per cent.

Compliance with the Code

In 2016–17, Code subscribers self-reported 8772 breaches.[397] In 2015–16, the number of self-reported Code breaches was 5021, a 33 per cent increase from 2014–15.[398] The majority of breaches across all reports was how insurers handled claims.

Several consumer representative groups recommended, as part of their submissions to the interim report of the review of the Code in 2017, that the Code sanctions should be expanded and that the Code be submitted for approval by ASIC. ASIC advised in its submission that it encourages the ICA to have early and ongoing discussions with ASIC about code approval under RG 183.[399] ASIC considers it critical that an industry code lifts industry standards. The key areas it identified for review to address the minimum standards include:

- reporting of systemic Code breaches and serious misconduct to ASIC
- compliance monitoring and enforcement
- remediation and sanctions, and
- periodic independent review.[400]

In the 2017 Review of the General Insurance Code of Practice Final Report, the ICA introduced recommendations to clarify what remedies might be available to consumers, and also to confirm the

397 General insurance in Australia 2016–17—*Industry practice and Code compliance Report*, p. 8.

398 General insurance in Australia 2015–16—*Industry practice and Code compliance Report*, p. 4.

399 ASIC submission to the General Insurance Code of Practice 2017 review, May 2017, p. 7.

400 Ibid.

intent to receive ASIC approval for the Code. The ICA noted that (in its view) current remedies available under the Code already meet RG 183, however to provide clarity it recommended that sanctions more directly mirror the wording in RG 183. This includes clarification that compensation may be given for any direct financial loss or damage caused to an individual, and clarification that the ICA can by resolution censure, fine, suspend or expel a member 'where a member wilfully refuses or neglects to comply with the provisions of the constitution…or is guilty of any conduct which in the opinion of the board is unbecoming of a member.'[401]

A further recommendation of the Code of Practice Final Review is that in order to meet ASIC approval of the Code, the Code should be amended to clarify that it is enforceable through the Code Governance Committee's (CGC) oversight and sanction powers (with FOS/AFCA taking Code breaches into account when determining disputes), and that the CGC can report systemic Code breaches and serious misconduct to ASIC.

We note that while the ICA maintain these remedies are already available under the Code, as heard in the 2018 Financial Services Royal Commission, the CGC has not imposed a single sanction on an insurer since 1 July 2014 despite over 700 reported breaches of the Code by member insurers.

The ACCC considers that this all demonstrates there is a strong case for the Code to lift its standards and seek ASIC approval under RG 183. This would increase confidence in the Code and ensure consumers know insurers can be held accountable for breaches. Importantly it will afford consumers greater protection and ensure they are made aware of, and provided access to dispute resolutions schemes, also providing insurers greater incentive to adhere to processes and minimise complaints.

We would welcome any action by the ICA to seek ASIC approval for the Code.

Recommendation 13: ASIC approval for the General Insurance Code of Practice

The Insurance Council of Australia (ICA) work with ASIC to obtain its approval for the General Insurance Code of Practice.

The ICA has indicated in its recent Code of Practice Final Review Report that in order to meet the requirements for ASIC approval it will make a number of changes to the Code. The ICA should work with ASIC to ensure that these changes are sufficient to meet at least the minimum standards in Regulatory Guide 183 to obtain ASIC approval.

401 ICA, *Review of the General Insurance Code of Practice Final Report*, June 2018, p. 69.

12. Mitigation

Key points

- Mitigation of natural hazard risk is an important component of efforts to reduce insurance premiums. It's a complex issue that requires a collaborative approach between government, industry and individuals.
- In consultation we heard that local residents questioned whether mitigation work carried out on a property was recognised by insurers. Property owners also commented that the main barrier to mitigation was often the large upfront capital investment required with no guaranteed return from reduced premiums over the long term.
- Some insurers provide premium discounts in response to mitigation works at a household level. While these discounts can be substantial for a small number of consumers, they are relatively modest for most, particularly when compared to increases in base premiums over time.
- Community level mitigation by governments can significantly reduce risks (and premiums) in some cases. Insurers have a central role to play in identifying possible measures and consequential premium reductions for consumers.
- Stronger Australian building standards have proven to be one of the most effective mechanisms for improving resilience. Properties built to modern standards are generally at less risk of sustaining costly structural damage. However, there appears to be scope for further enhancements to building standards to better protect properties from natural hazards and further assist with the long term affordability of insurance.
- There are opportunities for government and insurers to work together to avoid new developments in high risk areas where insurance premiums would be unacceptably high.

This chapter provides an overview of the techniques used to mitigate some of the risk of damage from natural hazards. In particular, we consider the extent and transparency of premium reductions made by insurers in recognition of mitigation activity either at the household level or larger scale public mitigation works. We also explore the potential for more proactive industry involvement in proposing possible projects and providing more certainty over the size and longevity of premium reductions for prospective projects. Finally, chapter 12 considers the importance of land use planning policies and building regulations to minimise risks for future developments.

12.1 Why is mitigation important?

In the context of disaster risk management, we can describe resilience as:

> A system or community's ability to anticipate, absorb, accommodate, or recover from the impacts of natural hazards in a timely and efficient manner, restoration of essential structures and functionality, and adapt to new circumstances.[402]

At the forefront of resilience is risk mitigation. Risk mitigation continues to be put forward by industry as a means to achieve permanent reductions in insurance premiums by reducing both the frequency and severity of claims. In the view of Suncorp, any approach to reducing insurance premiums that does not focus on mitigation will fail to reduce the cost of cyclone recovery and lock in a cycle of high premiums and government subsidies.[403]

Mitigation can be undertaken privately by individuals to protect their own properties[404] and publicly by governments to protect the interests of the broader community. For example, mitigation can be implemented through:

- adaptation measures: upgrading existing properties for greater physical resilience

402 Queensland Reconstruction Authority, *Queensland Strategy for Disaster Resilience 2017.*

403 Suncorp submission, p. 31.

404 Some mitigation activities (such as strengthening a roof) may also provide a spill over benefit to nearby properties as they are less likely to be damaged by debris.

- larger scale structural measures such as levees or dams
- land-use planning to prevent development in high risk areas
- building standards to ensure new properties have greater resilience
- community education initiatives.

In its 2015 report,[405] the Northern Australian Insurance Premiums (NAIP) Taskforce found that mitigation to reduce the risk of damage from cyclones is the only way to reduce insurance premiums on a sustainable basis. The Australian Government accepted the finding of the NAIP Taskforce (and on this basis, indicated it would not intervene directly in the insurance market).[406]

Some stakeholders have been critical, suggesting governments have overinvested in post-disaster reconstruction and underinvested in mitigation that would have limited the impact of natural disasters. The Productivity Commission Report into *Natural Disaster Funding Arrangements* also commented on the disproportionate spending between mitigation and post-disaster expenditure, citing mitigation spending remains unchanged at around three per cent of the post-disaster expenditure.[407] IAG proposed that this spending allocation should be rebalanced as a priority, with more investment in mitigation strategies to reduce the cost of reconstruction and safeguard communities.[408]

There can often be challenges for decision makers to find the right balance between hard mitigation (such as the construction of flood levees), and soft mitigation measures (such as education and risk awareness programs).

A number of insurers, insurance brokers and regional interest groups submitted that there is a role for governments to champion the shift in mindset towards investment in mitigation. The majority of insurers consider that investing in mitigation will build safer communities and a more sustainable future for northern Australia.

International research and initiatives also support the benefits of investing in natural hazard mitigation activities.

For example, the Sendai Framework is a voluntary, non-binding agreement developed by the United Nations and endorsed by Australia in 2015 which considers that the state has the primary role to reduce disaster risk but that responsibility should be shared with other stakeholders including local government, the private sector and other stakeholders.[409] The framework shifts the focus to disaster *risk* management, rather than disaster management and provides four priorities for action:

- Priority 1: Understanding disaster risk
- Priority 2: Strengthening disaster risk governance to manage disaster risk
- Priority 3: Investing in disaster risk reduction for resilience
- Priority 4: Enhancing disaster preparedness for effective response and to 'Build Back Better' in recovery, rehabilitation and reconstruction.

To complement efforts made by governments, the insurance sector also has an important role to play in improving understanding of disaster risk and encouraging investments in building more resilient communities.

12.2 Mitigation at a household level

The 2013 report prepared for the Australia Business Roundtable for Disaster Resilience and Safer Communities, *Building Our Nation's Resilience to Natural Disasters,* found that mitigation for existing

405 Northern Australia Insurance Premiums Taskforce, *Final Report*, November 2015.

406 Australian Government Response to the Senate Economics References Committee Report, *Australia's general insurance industry: sapping consumers of the will to compare*, December 2017.

407 Productivity Commission, *Natural Disaster Funding Arrangements*, Inquiry Report no. 74, December 2014.

408 IAG, *At what cost? Mapping where natural perils impact economic growth and communities,* November 2016.

409 United Nations Office of Disaster Risk Reduction, *Sendai Framework for Disaster Reduction 2015–2030*.

developed areas is the hardest but most important area for resilience action.[410] According to the report, changes to residential building codes (discussed in section 12.4) impact on about 1.3 per cent of the housing stock each year, implying that it would take on average about 44 years for such changes to cover the entire housing stock nationally.

Communities in areas now known to be in cyclone or flood risk areas pose a range of challenges for property owners, residents, governments and insurers. Retrofitting properties to be fully compliant with current building standards is rarely practicable, so the focus must shift to options available to reduce risk of damage. In its submission to the inquiry, the ICA highlighted a lack of understanding regarding the options, costs, and benefits of undertaking household-level mitigation may exist.[411]

Suncorp's '*Built to last—A Protecting the north initiative'* report suggests significant economic benefits can be achieved from investing in simple cyclone resilience home retrofits. Some simple mitigation options can pay for themselves after just one cyclone event.[412] In its submission to the inquiry, Suncorp claim that improvements could save home owners and the economy up to $13 for every dollar invested, and significantly reduce the amount of damage caused to the retrofitted household, and neighbouring households, when a cyclone hits.[413]

The ICA report *'A third way: A proposal for cyclone mitigation assistance'*, proposed that household-level mitigation measures would reduce premiums in some specific instances by up to 20 per cent.[414]

A study conducted by the Cyclone Testing Station (CTS) at James Cook University of insurance claims data identified that the most common causes of loss from Tropical Cyclone Yasi were roof damage, window damage and water ingress (in particular, wind-driven rain into properties through gaps and openings around windows and doors).[415]

The three key mitigation options identified in the report as the most likely to prevent damage to households from cyclones are:

- Structural roof upgrading, especially for homes constructed prior to 1980, or consider other practical retrofit options.
- Upgrades to opening protection around doors and windows for homes of all ages.
- Community preparedness and awareness campaign emphasising the importance of regular maintenance.

Barriers to improving affordability through household level mitigation

Improving the structural resilience of homes often makes financial sense, but there are still barriers to uptake.

The most significant barrier is the often large upfront investment required compared to the long term payback period, in the form of lower insurance premiums. This was a key theme of concern raised by local property owners during our public consultation.

Even mitigation actions requiring modest up-front costs with relatively short payback periods may be out of reach for low income consumers.

In its submission to the inquiry, Legal Aid Queensland similarly highlighted that for a private investment to be adopted by consumers it must have the practical effect of reducing insurance premiums. If it does not, it will not be successful.[416]

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410 Deloitte Access Economics, *Building Our Nation's Resilience to Natural Disasters, report for the Australian Business Roundtable for Disaster Resilience and Safer Communities*, 2013.

411 ICA submission, p. 18.

412 Suncorp, *Built to last—A Protecting the north initiative*, May 2016.

413 Suncorp submission, p. 31.

414 Insurance Council of Australia, *A Third Way: A proposal for cyclone mitigation assistance*, September 2015.

415 Cyclone Testing Station, *CTS Report: TS1004.2—Insurance Claims Data Analysis for Cyclones Yasi and Larry, 2015.*

416 Legal Aid Queensland submission, p. 11.

Consumers contemplating private mitigation investments may be able to relatively easily gain a good understanding of the costs of the investment, by receiving quotes for the work and by a number of public documents giving indications of typical costs of mitigation efforts. However the benefits are less certain because:

- It is hard for consumers to forecast the size of the reduction in premium that would occur following the mitigation investment. There is limited public information on the typical size of premium decreases resulting from different kinds of mitigation efforts. Even if typical premium reductions for mitigation were better known, individual mitigation efforts may produce very different changes to premiums due to differences in the initial level of risk of the location and property characteristics and due to differences in premium reductions between insurers.
- Consumers may anticipate that it will be hard to verify that they ultimately continue to receive a premium reduction resulting from the mitigation. As discussed in chapter 5, the way insurers calculate premiums is complex and not visible to consumers. Premium changes from year to year can be significant, based not only on updated risk information but also market adjustments. Consumers will typically have no way of knowing the precise reason or reasons for an overall premium increase. As such, it can be difficult for consumers to have confidence that discounts for mitigation activities undertaken are not being offset by future market adjustments made to the pre-discount premium. This is particularly the case where other components of the premium are changing significantly.
- Consumers may anticipate that any mitigation efforts would not be taken into account or result in a reduced premium if they switched insurers. Uncertainty over the extent to which other insurers would recognise mitigation efforts could also reduce any future incentive for the consumer to consider switching insurers.

Having undertaken mitigation works in response to an insurer's discount program, a consumer may also be less inclined to consider competing insurers' products in subsequent years due to uncertainty over whether the works would be adequately or easily recognised.

Taken together, this uncertainty over future benefits can make it harder for consumers to justify the often substantial up-front costs of mitigation.

Further barriers may be particularly prevalent in the case of rental properties where there is an imbalance in the allocation of costs and benefits between the landlord and the tenant. That is, the landlord incurs the costs of investing in mitigation to improve the property, but some of the benefits may accrue to the tenant via improved protection of their contents. The degree to which these costs and benefits would be reflected in rents is not clear.

Similarly, where strata schemes are required to have building insurance, they face a potential coordination problem when it comes to mitigation efforts. While a mitigation effort may be worthwhile for the strata scheme as a whole, it may not suit all owners. Owners may benefit differently from any improvements to insurance coverage or have different willingness or ability to incur investment costs, so there may not be sufficient agreement between owners to proceed with some higher cost improvements that would require a contribution from all owners.

Body corporate management rules may also prevent property owners in certain complexes from improving the structural rigidity of their properties (such as, upgraded fences or over roof battens) for aesthetic reasons unless prior approval is granted at body corporate meetings. In its submission to the inquiry, Strata Community Association (SCA) suggested that funding of significant mitigation work is generally cost prohibitive.[417]

The next sections report on measures that insurers and governments have taken to overcome these barriers, or could take in the future.

417 Strata Community Association submission, p. 3.

How insurers can support private mitigation

The ICA is of the view that industry has a role in promoting mitigation, but it should not be paying for mitigation. The role of insurers in the mitigation process is to price residual risk appropriately and fairly, using the best available data.[418]

Insurers generally assess a property's structural integrity and resilience to natural hazards through a series of targeted questions (for example, online quote calculators which ask about a property's features and location to inform the quote supplied). In this way, the quote is based on the expected exposure risk associated with the property. Some insurers also promote mitigation discounts to property owners in northern Australia for undertaking certain mitigation activities. Boxes 12.1 and 12.2 detail examples from RACQ and Suncorp.

While only two insurers offer explicit discounts for mitigation, the rating factors used by other insurers can account for risk mitigation works to some extent. For example, one insurer notes its cyclone model rates cyclone risk by wall and roof construction, age of building, and it also considers cost reductions for retro-fitted properties. However, some insurers also consider that there is currently insufficient historical data to accurately take mitigation works into account.

We note, some insurers have recently considered introducing incentive driven mitigation programs however had not proceeded, in one case because their pricing systems do not make provisions for post construction mitigation works and/or features. The NAIP Taskforce reported that some insurers are developing systems to better capture information about mitigation and to have this reflected in premiums.[419]

A very clear theme of our public consultation was that the insurance industry must stand by individuals who invest in mitigation and recognise the reduction of risk with a reduction in premiums. Individuals would be more encouraged to undertake mitigation if there was a clearer link between mitigation and lower insurance premiums. There were many local residents and land owners across Australia who did not feel this was happening in a way that they understood or expected.

For example, at the Karratha public forum, residents questioned how/whether insurers were taking into consideration mitigation work carried out at a property, especially where consumers had an engineer review the property's compliance with the building codes. At the Rockhampton and Broome forums, brokers noted the importance of providing evidence of mitigation works undertaken to obtain a lower premium.

The NAIP Taskforce also proposed that insurers could give greater recognition to postconstruction mitigation work when calculating insurance premiums. The taskforce said policy holders are more likely to undertake mitigation if it directly linked to lower premiums.

In its submission, Suncorp indicated it has provided 35 000 consumers with a 'Cyclone Resilience Benefit' on insurance where their homes are cyclone-resilient.[420] Suncorp said customers who received the discounts had typically upgraded roofs, covered windows, strengthened doors, and undertaken cyclone-season maintenance and preparation.[421] In some cases, Suncorp has taken hundreds of dollars off their premiums.[422]

418 ICA submission, p. 18.

419 Northern Australia Insurance Premiums Taskforce, *Final Report*, November 2015, page xiv.

420 Suncorp submission, *Protecting the north—An insurance affordability and cyclone resilience policy proposal*, p. 4.

421 Suncorp media release*, Suncorp welcomes funding for Queensland cyclone resilience*, 8 November 2017.

422 Suncorp media release, *North Queensland homeowners rewarded for cyclone resilience*, 18 May 2017.

Box 12.1 Suncorp's Cyclone Resilience Benefit

In 2016, Suncorp launched its Cyclone Resilience Benefit (CRB) which it promotes as rewarding certain consumers in North Queensland with premium reductions of up to 20 per cent for making their homes more cyclone resilient. Suncorp also provides a cyclone resilience benefit to eligible properties in Northern Territory and north Western Australia.

For a property to be eligible to receive a Cyclone Resilience Benefit it must be north of the Tropic of Capricorn and within 100km from the coast line and meet the criteria of improved building features or cyclone mitigation measures present. The initiative rewards consumers that undertake any of the five mitigation measures which demonstrate a property's improved ability to withstand the impacts of cyclones. These measures relate to aspects of a home such as upgrading the roof, windows, doors, shed, as well as cyclone preparation in general (for example, moving unsecured outdoor furniture inside).

A greater resilience rating (up to five stars) should reflect a consumer's improved risk profile and therefore, reduced premiums.

Data obtained by the inquiry indicates that of all CRB recipients, over two thirds were still receiving a discount of less than five per cent, and less than three per cent are receiving a CRB of more than 15 per cent on their premium.

In its submission to the inquiry, RACQ noted its support for mitigation works as 'the foundation of any and all efforts to reduce insurance premiums on a sustainable basis.'[423] RACQ submitted it recognises efforts and depending on the range of mitigation activities undertaken on the property, different discounts will be achievable.[424] RACQ's Cyclone Mitigation Discount scheme is discussed in box 12.2.

Box 12.2 RACQ's Cyclone Mitigation Discount

In 2016, RACQ launched a scheme offering premium discounts of up to 20 per cent to certain consumers in north Queensland under its Cyclone Mitigation Discount. Property owners in north Queensland may be eligible for RACQ insurance premium discounts if a home they own and/or live in has undergone work to reduce its risk of cyclone damage, for example:

- the installation of roofing options such as over batten systems and/or strapping
- the installation of opening protection
- a complete roof replacement or a complete retrofit—to the current building code.

The offer of a premium discount to an eligible RACQ customer is subject to the Structural Changes having been undertaken and is at the discretion of RACQ Insurance.

In 2017–18, the average cyclone mitigation discount in Queensland was $350.

The above examples illustrate that, while premium reductions are possible in response to mitigation activities, the scale of the reductions for most customers can be modest. It is important to note that the expected average percentage reduction on post-1980 properties would generally be less than on pre-1980 properties which would ordinarily be starting from a lower base of resilience, and could achieve a greater mitigation discount for structural improvements.

Under both the RACQ and Suncorp mitigation discount programs, there is a degree of transparency around what rating system is used to determine a properties level of exposure (for example, the online quotes calculator questions and cyclone resilience questionnaire).

More broadly, there is value in signalling to consumers how they could go about further reducing their risk profile and achieve lower premiums. It is important for consumers to understand what discounts have been provided on a quote or renewal notice in recognition of property features that mitigate risk. For this information to be of most benefit to consumers, it should be provided by an insurer either on a

423 RACQ submission, p. 4.

424 Ibid.

renewal notice or a quote for new business. As well as improving transparency about how an insurance premium has been calculated, this would act as a prompt so that consumers could alert an insurer to other relevant property characteristics that could support a (further) reduction in a premium.

This requirement would necessarily require insurers to disclose, during their quoting process, an aspect of their pricing approach. This may in turn then be visible to competitors (either because the adjustment is built into publicly accessible quote engines, or because a consumer can share the breakdown of the mitigation specific information with a different prospective insurer).

We note that this is no different to the present situation where insurers already have visibility of the premium adjustments made by competitors for changes in sum insured or excess amounts. Greater transparency around premium pricing and what discounts have been provided could also address any misconceptions that the full discounts are not being passed on to consumers.

Draft recommendation 12: Clearly stated mitigation discounts

The Insurance Contracts Regulations should be amended to require insurer quotes and renewal notices for a property to expressly show what discounts have been applied (if any) to reflect mitigation measures undertaken on that property.

This is important to help ensure premium adjustments are comparable between insurers and transparent for consumers. It also provides clarity to consumers and assists with evaluating investments in mitigation works.

The provision of specific and accurate risk information may improve a property owners' awareness of the risks faced, and encourage them to take appropriate action to manage these risks. Insurers are best-placed to know what potential improvements could be considered given a building's current characteristics. More importantly, only an insurer will know the level of discount in premiums (if any) that it would apply in response. The renewal notice or quotation is the logical place for this information to be provided. For example, the statement could advise on what impact the adoption of common measures (e.g. installing cyclone shutters over windows or reinforcing a roof) would have on the property's assessed risk and premium.

A consumer's decision on whether or not to invest in a given mitigation measure would benefit from certainty regarding future premium reductions. However, given the complexity and uncertainty involved in insurers' pricing decisions, it may not be practical to require estimated premium reduction for beyond the immediate insurance period.

Nevertheless, the estimate provided should be the insurer's best estimate given the information that it has available about the consumer's property characteristics and its own pricing methodology. Consumers would still be in a far better position to make an informed mitigation decision with this single estimate, than without.

There could be a very large number of mitigation options available to a consumer, some more feasible than others. Again, an insurer would be best placed to know which of the options available have the potential to result in meaningful premium reductions based on their own experience. The obligation to provide information on possible mitigation measures could be limited to those measures already undertaken by other customers of the insurer.[425] Beyond this, we also encourage insurers to identify new, cost-effective or innovative approaches that will assist with premium reductions over the long term.

425 Chapter 9 on consumer information and choices considers the no advice / general advice models for insurance providers in more detail.

Draft recommendation 13: Information on mitigation works that could reduce premiums

The Insurance Contracts Regulations should be amended to require insurer quotes and renewal notices for home insurance to provide a schedule of mitigation measures which customers of the insurer have undertaken for properties with similar characteristics in order to improve their risk rating. This should include a guide to the premium reductions (in percentage terms) that consumers have received for undertaking these measures.

This would provide (new or renewing) consumers with current information on a practical range of actions that could be undertaken to mitigate risk and show them what the benefit could be in terms of premium reductions. This will assist consumers to decide if the risk mitigation option is worth the upfront cost.

How governments can support private mitigation

Some advocates of disaster risk management have proposed a government-funded retrofit program targeting older housing would be one of the most effective ways to keep insurance affordable.[426] For example, the Insurance Council of Australia commissioned research in 2015 that proposed a seven-year $361 million scheme to retrofit vulnerable buildings in Queensland.[427] The ICA report, *A third way*, reported it would cost between $12 000 and $15 000 per house to fit roof over-battens, and proposed a role for a government subsidy.[428]

The NAIP taskforce considered a government subsidised mitigation scheme would likely be costly and risky, however, it was considered the only way to enable low income households to complete substantial mitigation work to their property.[429] Allianz supports this notion but also concluded in its submission that for many properties highly vulnerable to flood and cyclone, affordable home insurance could only be delivered through some form of subsidy arrangement which should not eliminate the price signals insurance can provide about risk.[430]

Since 2013, the Australian Government has committed $30 million to the Queensland Government under the *National Partnership Agreement on Natural Disaster Resilience* to support local projects that build the disaster resilience of Queensland communities.[431] The Australian Government has also contributed over $10.5 billion under the *Natural Disaster Relief and Recovery Arrangements* over the last decade to support recovery efforts nationally. Of this, more than $9 billion has been provided to Queensland.[432]

Governments at all levels have a role to play in supporting mitigation action. A number of examples of government schemes and initiatives to improve the accessibility of mitigation to local residents and property owners are set out in boxes 12.3 to 12.7.

426 Deloitte Access Economics, *Building Our Nation's Resilience to Natural Disasters, report for the Australian Business Roundtable for Disaster Resilience and Safer Communities*, 2013.

427 ICA media release, *Insurers propose practical solution to resolve North Queensland premiums issue*, 7 October 2015.

428 Urbis, *A Third Way: A proposal for cyclone mitigation assistance*, September 2015, p. 6.

429 Northern Australia Insurance Premiums Taskforce, *Final Report*, November 2015, p. 88.

430 Allianz submission, p. 19.

431 The Hon Kelly O'Dwyer MP, Media Release: James Cook University to undertake the Strata Title Inspection Scheme, 26 October 2017.

432 Ibid.

Box 12.3 Australian Government's Strata building engineering inspection scheme[433 434]

In the 2014–15 Budget, the Australian Government allocated $12.5 million of funding to the Queensland Government for strata-title engineering assessments in north Queensland. The Budget Measures indicate the assessments will provide better information to insurers which will enable them to set premiums that more accurately reflect individual property risks.[435] The assessments will also help residents of strata-title properties to be fully aware of the risks to their properties from natural disasters. This will provide bodies corporate with an opportunity to take necessary action to mitigate those risks and reduce their risk assessment by insurers, and ultimately reduce insurance premiums in some cases.

Box 12.4 Queensland Government's Household resilience program grant scheme

The Queensland Government announced a Household Resilience Program which provides a cofunding arrangement option to assist eligible home owners to improve the structural resilience of their pre-1984 homes against cyclones.[436] Eligible home owners can apply to receive a state government grant to cover 75 per cent of the cost of improvements (up to a maximum of $11 250 including GST). The program covers improvements options such as roof or garage door replacements.

The Queensland Government recently announced it had received applications from 360 households within two months of the program commencing, including from the region between Bundaberg and Cairns. [437] It indicated 45 projects and almost 92 per cent of the applicants had home insurance, and would expect that insurance companies will take into account the improved resilience of these homes in calculating insurance premiums.

Box 12.5 Cairns Regional Council's Resilience scorecard project

The Cairns Regional Council submitted to the inquiry, their approach to community betterment was to run a resilience scorecard project in the region, which develops a benchmark of community and infrastructural resilience using a range of score criteria. One of these criterion includes encouraging the improvement of private and personal property risk mitigation for the region. The council noted that while there has been little engagement or support in these types of initiatives from insurers, the general resilience of the community has improved.

Box 12.6 Townsville Cyclone Sunday

Cyclone Sunday is a free community-awareness event for the public and new residents to Townsville. It informs the community on how to be 'Cyclone Ready' at the beginning of the Cyclone Season. It provides residents the opportunity to talk directly with community and emergency organisations and get information available to assist residents prior to, during and after a cyclone.

433 Ibid.

434 The Hon Kelly O'Dwyer MP, Media Release: *Government responds to Northern Australia Insurance Premiums Taskforce and General Insurance Senate Inquiry*, 18 December 2017.

435 Australian Government Budget 2014–15, *Budget Paper 2—Budget Measures*, p. 212.

436 Queensland Government Media Release: *Palaszczuk Government to fund storm protection for coastal homes*, 27 July 2018.

437 Queensland Government Media Release: *Cyclone resilience program clicks with Queenslanders*, 19 September 2018.

Box 12.7 Brisbane City Council's FloodWise

The Brisbane City Council[438] has attempted to bridge the knowledge gap by providing 'FloodWise' Property Reports to assist residents with understanding the risk and type of flooding that may impact their property. The aim of this program is to enable residents to plan ahead and build habitable floor levels in accordance with Brisbane City Council's requirements. The information contained in the report is based on flood studies and utilises the latest flood computer modelling. The reports shows, for the purposes of information (but subject to caveats) a new one per cent Annual Exceedance Probability (AEP) level from the Brisbane River Flood Study which is yet to be adopted in land use planning schemes.

The ICA[439] and insurers[440] have voiced their support for the strata building engineering inspection scheme (box 12.3), citing the James Cook University report into the resilience of strata properties, which recommended regular engineering based inspections be carried out on strata titles in order to identify issues of deterioration that could decrease building resilience in cyclones.[441] Several submissions to our inquiry however, questioned the status of the scheme, but looked forward to assessments commencing in the region as soon as possible.[442]

As noted above, even mitigation actions with a relatively short payback period may be beyond the means of low income consumers. Obtaining personal finance to cover the upfront costs is unlikely to be feasible in most cases, particularly because of the uncertainty that will exist regarding premium reductions and premiums levels generally, beyond the current insurance period. Furthermore, even with specifically designed and prominent cyclone mitigation programs in place (by Suncorp and RACQ), most people participating could only get a discount of up to 10 per cent or less.

As demonstrated above, there can be a role to play for governments in assisting consumers to overcome these impediments and make their homes more resilient. Chapter 5 considers the level and impact of taxes and duties on insurance premiums. As reported there, the amount received through taxes and duties in northern Australia has grown from $48 million in 2007–08 to $157 million in 2017–18.

Such revenue, of course, is required to meet a range of governmental spending needs. However, as discussed in chapter 5, there may be merit in drawing on this windfall gain for measures to fund mitigation works, if stamp duties are maintained.

12.3 Public mitigation

In this section, we consider investments by governments in largescale 'hard' mitigation projects, such as the installation of flood levees, well-maintained drainage networks, dredging of rivers and appropriate management of dams. The following section 12.4 further discusses the forward looking role for mitigation through the use of land use planning and building regulations.

The ICA in its submission to the PC's Inquiry on *Natural Disaster Funding Arrangements*, indicated that mitigation infrastructure should be managed as infrastructure by agencies with appropriate responsibilities, the required expertise and understanding of large-scale projects.

Suncorp in its submission noted it commissioned a cost-benefit analysis on key regional flood mitigation projects in 2014.[443] It found two flood levees built in regional Queensland towns would deliver economic returns of around five times the cost (see below for further detail on the levees). Flood levees play an important role in floodplain management. They also have the potential to impact on neighbouring properties, the community and the catchment as a whole.

438 Brisbane City Council, FloodWise Property Reports.

439 ICA Media Release, *Independent strata study recommends regular inspections to reduce premiums*, 24 October 2013.

440 For example, RACQ Submission to the Australian Government Discussion Paper, *Addressing the high cost of home and strata title insurance in North Queensland*, 9 May 2014, p. 7.

441 CTS report TS899 to the ICA, *Pilot study: Examination of strata building risks from cyclonic weather by utilizing policy claims data,* June 2013, p. 33.

442 See for example, Margaret Shaw submission and Suncorp submission, *An insurance affordability and cyclone resilience policy proposal*, p. 9.

443 Suncorp submission, p. 30.

But the reality of developing in high flood risk areas is, as Floodplain Management Australia (FMA) noted in its submission, that levees can rarely, if ever, provide complete protection from all possible floods as there almost always remains some risk of a flood higher than the design height of the levee.[444] This, and the potential for levee failures mean that properties 'protected' by the levees cannot be considered completely flood-risk free, and insurance premiums are likely to contain some provision to cover this.

Examples of public mitigation efforts in northern Australia

Price signals provided by insurance can be an effective way to convey information about risk and encourage risk management, including through public mitigation works. Some insurers have previous temporarily embargoed certain addresses from their underwriting systems, effectively 'leaving the market' for a period of time to reduce their exposure to a high risk area.

An important example is Roma in Queensland (outside of northern Australia), where insurers' decisions to place a temporary freeze on writing new business has led the state and federal governments to commit funds to build a flood levee. The case of Roma is often used for comparison and examples of mitigation works in other parts of Queensland. See box 12.8.

Box 12.8 Examples of public mitigation in flood levees: Roma, Queensland (4455)

Roma is often discussed as the flood mitigation success story where properties were protected in a once flood-prone town, with long term cost savings for insurers and residents.

Roma experienced several major flooding events in 2010, 2011 and 2012 due to its location along Bungil Creek, a tributary of the Condamine River. Following the floods, certain insurers announced that they would no longer underwrite new policies for Roma residents until flood mitigation works were carried out.

The insurance price signal delivered by the industry was, according to the ICA, considered by most insurers and consumers alike as unsustainable.[445] A Suncorp statement suggested at the time, initial estimates for a typical $300 000 home inside the new levee indicate that Roma residents may see an average reduction in their premium of about 30 per cent once the levee is completed, but could be as high as 80 per cent in some of the most flood-prone areas.[446]

The Roma flood levee project comprises two stages at a cost of $16.4 million.[447] Stage one of the levee is suggested to protect at least 490 homes from flooding, and stage two to protect an additional 30 buildings.[448]

Information we obtained from two insurers indicated that they provided public mitigation discounts of around 21 and 30 per cent as an immediate response for new customers in Roma.

In places such as Roma and St George, where the decision has been made to deliver improved mitigation infrastructure, Suncorp reported it had reduced premiums by up to 90 per cent to reflect the reduced risks.[449]

Barriers to improving affordability through public mitigation

The Roma case study above is a stark example of strong insurer price signals (and even embargoes) signalling the assessed risk to properties in an area, with a clearly identified project to benefit a significant number of homeowners. However, in most scenarios, there can be significant barriers to public mitigation works that could bring about more affordable insurance premiums.

444 Floodplain Management Australia submission, p. 2.

445 ICA submission, p. 14.

446 Suncorp media release, *Suncorp starts writing new business as Roma levee kicks off*—24 September 2013.

447 Suncorp submission, p. 30.

448 Suncorp media release, *Suncorp welcomes decision on Roma flood mitigation*—9 January 2017.

449 Ibid.

Both insurers and governments may have access to detailed, but different, hazard mapping, however, only insurers will have a clear understanding of the potential impact of mitigation measures on insurance premiums. The likely effect on premiums will be a key consideration in any decision on whether or not to undertake a project.

Emerald and Rockhampton, both towns in northern Queensland, have each had flood studies undertaken.[450] However, as yet, neither town has commenced developing any large scale mitigation strategy.

Box 12.9 Rockhampton, Queensland—4700 and 4701 postcode

The proposed South Rockhampton Flood Levee has been identified as the most cost effective option to mitigate the effects of flooding. Rockhampton has experienced 17 moderate and major flood events in the past century or about one every six years.[451] It was first identified in 1992, was further supported by updated modelling in 2011, and more recently 2014.

The proposed flood levee is estimated to cost around $48 million but expected to protect around 1000 homes, particularly in Gladstone Road, the lower CBD, Depot Hill, Port Curtis and Allenstown.

Suncorp has publicly indicated that the average premiums for homes exposed to flood risk will likely reduce by around 32 per cent or around $400, as the number of properties assigned to a nil flood risk rating is increased by 14 per cent.[452] Previous analysis by IAG has proposed a levee would offer protection from flood events up to approximately the 1-in-200-year flood, where some properties could currently be impacted by flood events as small as the 1-in-20-year flood. Further, IAG suggested over 800 properties would see a large saving of over $3000 on their home buildings and contents premium.[453]

Council is currently investigating options for funding its share of the project. These options include possible contributions from industry and those property owners that will directly benefit from the project. A final decision to construct the levee will not be made until the current planning and design work is completed, the projects technical viability is confirmed and a suitable funding arrangement has been established.[454]

As with household level mitigation, discussed above, the uncertainty regarding the magnitude and longevity of insurance premium reductions can make funding for the up-front cost of such measures difficult to secure. This problem is further complicated in the case of public mitigation by the fact that the beneficiaries of the activity (affected property owners who may or may not be insured) are not also the decision makers. However such coordination problems are not unique to public mitigation.

Governments must routinely make decisions on what projects to fund from general revenues, through special levies or taxes or through user charges. Suncorp has raised the idea of utilising some of the funds from the Northern Australia Infrastructure Facility to invest in community resilience and mitigation infrastructure in high risk areas such as South Rockhampton.[455]

Regardless of the funding approaches that may be considered, public mitigation measures have very little chance of progressing in the absence of greater information disclosure by insurers regarding potential projects, and a solid ongoing commitment to meaningful premium reductions. To build confidence in public mitigation measures, insurers should be prepared to disclose the actual premium reductions that result from them.

450 Flood study of Emerald, Qld: www.myfloodinfo.com.au/; Flood study of South Rockhampton, Qld: www.rockhamptonregion.qld.gov.au/CouncilServices/Disaster-Management/Floods/Flood-Mitigation/South-Rockhampton-Flood-Levee.

451 Suncorp General Insurance Submission to the PC Natural Disaster Funding Inquiry, June 2014, p.10.

452 Ibid.

453 Insurance Australia Group Submission to the PC Natural Disaster Funding Inquiry, June 2014, appendix pp. 25–26.

454 Rockhampton Regional Council website, www.rockhamptonregion.qld.gov.au/CouncilServices/Disaster-Management/Floods/Flood-Mitigation/South-Rockhampton-Flood-Levee, last accessed 30 October 2018.

455 Suncorp submission, *Protecting the north—An insurance affordability and cyclone resilience policy proposal*, p. 7.

Recommendation 14: Public mitigation works and expected premium reductions

The insurance industry should work with governments to identify specific public mitigation works (e.g. flood levees) that could be undertaken and insurers should provide estimates of the premium reductions they anticipate should the works proceed.

Actual premium reductions following such works should also be publicly reported by insurers, measured against their estimates.

12.4 Developing and building for resilience

An effective policy and regulatory framework can lessen a community's exposure the risk of damage from natural hazards:

- Governments must develop and enforce region-appropriate land planning guidelines, and
- Developers of new properties must design and build consistent with construction codes, which must keep up with new knowledge, technology and the evolving environment.

Effective land-use planning and decision making

Decisions about where people live, how land may be used and the types of buildings that can be constructed influence the exposure and vulnerability of the built environment to a range of natural hazards. The Productivity Commission regards land-use planning as one of the most powerful policy levers available to governments to mitigate against the effects of natural hazards.[456]

Land use planning can reduce the development of communities in areas where risk profiles have increased over time, or first settled when these risks were not present or fully understood.

In its submission to the inquiry, the Mackay Regional Council[457] also acknowledges the role of local governments, in particular by:

- ensuring land use planning takes into account the natural hazard risks—this is done via the planning scheme and overlay codes (flood and coastal hazards)
- improving risk mitigation against natural hazards such as through levees, and
- providing accurate flood risk information to insurers for the purposes of informing pricing decisions and residents to better prepare them for surviving natural disasters.

IAG submitted that there were instances where it could be identified that land use planning did not always incorporate natural disaster risk.[458]

Suncorp in its submission to the inquiry suggests that north Queensland faces significant planning legacy issues, and recommends that caution be exercised during future planning and development decisions at a local and state government level to prevent more homes and businesses unnecessarily paying for high flood risk.[459]

The Australian Business Roundtable for Disaster Resilience and Safer Communities 2013 report, *Building our Nation's Resilience to Natural Disasters*[460] highlighted the importance of prioritising the collection and co-ordination of national natural hazard data, to properly inform state and locally based land use planning reforms. IAG's submission to the inquiry suggested that only when this has been completed can the national building codes be 'geographically addressed accurately and adequately'.[461]

456 Productivity Commission, *Natural Disaster Funding Arrangements*, Inquiry Report no. 74, December 2014.

457 Mackay Regional Council submission, p. 3.

458 IAG submission, p. 31.

459 Suncorp submission, p. 21.

460 Australian Business Round Table for Disaster Resilience and Safer Communities (ABRDRSC) commissioned Deloitte Access Economics to prepare the *Building our Nation's Resilience to Natural Disasters Report,* June 2013.

461 IAG submission, p. 31.

FMA in its submission to the inquiry noted that when the insurers generally hold access to high quality flood data, premiums can be set to more accurately reflect the real risk.[462] Most councils possess flood studies and mapping of varying degrees of accuracy, which can assist insurers to better understand flood vulnerability.

Some stakeholders argue there is also a role for the government in ensuring the collection of natural hazard data is maintained in a central location. Governments of all levels share various natural hazard information sets, including flood and cyclone data. See box 12.10.

Box 12.10 Government sharing hazard data and information sets with stakeholders

Governments can contribute regional flood studies to the National Flood Information Database (discussed in chapter 5) to inform industry's understanding of flood risk in a particular region and assist with the more accurate pricing of insurance premiums. The sharing of these studies may be infrequent and is more likely to occur following public mitigation works which, for example, have altered or improved the flow of a flood water away from higher risk properties.

The Australian Government through Geoscience Australia maintains a number of free and publicly available resources, including:

- The Australian Flood Risk Information Portal[463] which collates information shared by local, state and territory governments and other sources including the Australian Flood Studies Database (a repository of flood maps and flood studies). Where data is available, it can be used by town planners, engineers, and the insurance industry to better understand a regions flood risk and ensure any new developments occur in lower risk areas.
- The Tropical Cyclone Hazard Assessment[464] data which calculates the likelihood and intensity of tropical cyclones in Australia. New data was released on 1 November 2018 and provides valuable information for land-use planning decision makers and authorities that develop mitigation strategies and emergency/disaster management plans. It is also suggested the insurance industry could use this data to further understand tropical cyclone risk as an input to pricing insurance premiums.

We recognise the importance of developing and adopting effective land use planning arrangements integrated with natural disaster risk management for communities in northern Australia, and more broadly across all states and territories. Land use planning decisions can have long term impacts on communities and poor decisions are extremely difficult to reverse. It is imperative that communities are developed in areas that avoid excessive exposure to natural hazards, in particular flood risk. A failure to do so will only magnify present concerns around the affordability (and availability) of insurance in the future.

Any reluctance by local governments to sharing their data (such as, regional flood mapping and modelling of exposure to risk data) with insurers is understandable given insurers' shift away from a pooled pricing model towards more granular address level pricing. Local governments would be aware that any new data supplied would feed into risk and pricing models which could lead to certain properties being reclassified as at a higher risk resulting in an increased premium.

Equally, insurers may not be as forthcoming with the sharing of their data for various reasons. Historical claims data is extremely valuable to insurers as it allows them to more accurately determine the probability of a claim and set premiums accordingly (as noted in chapter 5). Some data including natural peril models and mapping information are licenced through third party vendors and subject to terms of use agreements. This information is available to persons at a cost. Also, insurers can share and obtain flood related information through the National Flood Information Database which can further their capability to price the risk. Access to this databased is controlled by the ICA.

Nevertheless, where such data represents a more accurate assessment of risk, there remains a compelling case for a more open exchange of data from governments to insurers and the public.

462 Floodplain Management Australia submission, p. 1.

463 Geoscience Australia, Australian Flood Risk Information Portal, www.ga.gov.au/flood-study-web/#/search.

464 Geoscience Australia, Tropical Cyclone Hazard Assessment, www.ga.gov.au/about/projects/safety/tcha.

However, there are equally strong arguments for insurers sharing their data with local governments and other planning authorities. By making natural hazard data available, the capabilities of government decision makers and developers to make appropriate decisions prior to developments is likely to aid mitigation of risks.

There may be longer term issues that stem from a lack of data transparency, in particular, the sharing of natural hazard risk data between government and insurers, and vice versa. For example, if developments proceed in an area known to insurers to be higher risk, this will lock in insurance affordability issues for a considerable period or otherwise require costly mitigation works to be undertaken by property owners or governments.

As noted above in relation to public mitigation works, insurers are also best placed to estimate the cost of insuring properties in new developments. Such estimates, if they were sought by planning authorities, may compliment their own hazard assessments by providing an insurance price signal regarding the desirability of development in particular areas.

During consultation, concerns were raised that local governments' development objectives were prioritised over, and conflict with, appropriate land use planning decisions. For example, a stakeholder at the Mackay public forum was concerned the Mackay Waterfront Priority Development Area proposal would be developing over a high risk area.[465] In its submission to the inquiry however, the Mackay Regional Council advised that flood and coastal hazards were a primary consideration in zoning decisions and the proposed development area met the council's defined flood event criteria.[466]

We note consumers are likely to assume that new developments which have recently passed through a land use planning process have been designed in a way to limit exposure to natural hazard risks. For example, where a new development is developed in an area which has previously flooded, construction required such as raised floor levels, have been required.

We also note that purchase of home and contents insurance is unlikely to be a priority for most consumers when they are purchasing a property. It is generally only when a consumer comes to purchase or take ownership of a property that they consider the cost of insuring it.[467]

More generally, any specific known hazards to a property (for example if a property is in a location deemed to be at a high risk of flooding/storm surge) should be disclosed clearly by developers or real estate agents.

Building regulations

Building regulations play an important role in managing natural disaster risk. The structural design of buildings and the quality of building materials can influence the resilience of buildings to natural disasters. This, in turn, can lead to lower insurance premiums for these properties. We also recognise that more stringent building regulations can add to the cost of building (at least in the short term) and that this in turn can influence insurers' pricing decisions (see chapter 5).

The Australian Building Codes Board (ABCB) is responsible for the development and maintenance of the National Construction Code (NCC), which comprises the Building Code of Australia (BCA) and the Plumbing Code of Australia. The ABCB is a joint initiative of the Commonwealth, state and territory governments. It was developed to address the inconsistences in standards across regions by setting the minimum requirements for health and safety, amenity and accessibility, sustainability in the design, and construction and performance of new buildings throughout Australia.[468]

It is the role of each state and territory government to adopt and enforce the recommended standards. In Western Australia and Queensland, local governments can choose to impose additional building requirements through council by-laws (or guidelines) to apply to their region. In the Northern

465 Northern Australia Insurance Inquiry Public Forum, Mackay, Queensland December 2017, summary available at www.accc.gov.au.

466 Mackay Regional Council's defined flood event criteria is a one per cent annual exceedance probability.

467 See Chapter 9 on consumer information and choices which includes a draft recommendation that insurance information be included in real estate vendor statements.

468 Australian Building Codes Board, *Annual Business Plan 2018–19.*

Territory, the territory Government has the primary responsibility for implementing building and planning regulations.

The NCC is a uniform set of technical provisions for building works throughout Australia which also accounts for variations in climate and geographical conditions. The NCC is only changed where the ABCB is satisfied that the benefits exceed the cost. Changes to the NCC are subject to compliance with COAG best practice regulatory principles which includes a cost benefit analysis, preparation of a regulation impact statement (RIS) to examine the full implications of any potential changes, and consideration of available data and research.

Box 12.11 Natural disaster events that have prompted action

In 1974, Cyclone Tracy caused 65 deaths and hundreds of millions of dollars of damage to 70 per cent of Darwin's homes (90 per cent in some areas). It prompted regulatory change to improve the construction processes that attach the roof to the house, making houses more resistant to severe wind damage.

Analysis after cyclones Vance (1999), Larry (2006) and Yasi (2011) showed that the updated regulations have resulted in much less building damage and consequent loss of life. During Cyclone Yasi, for example, 12 per cent of older homes suffered severe roof damage, but only three per cent of newer homes.

Residents of Innisfail faced the full brunt of Cyclone Larry in 2006 with wind gusts of 240 kilometres an hour. The rebuild brought many damaged houses in the town up to modern, cyclone resilient standards. When Cyclone Yasi crossed the coast with similar wind speeds five years later, claims from Innisfail were half the cost of those nearby towns that did not experience the post-Cyclone Larry rebuild.

Australia has made significant advances in the building regulations, in particular in the 1980's when the NCC was introduced. The framework has also been modernised to reflect new and updated understandings of how natural hazards may impact communities.

In Western Australia, building codes have required standards to meet a category four cyclone since 1974. For example, the Town of Port Hedland and Karratha are located within one of the most severe cyclonic wind regions in Australia. As such, all structures are required to be designed using durable materials (such as concrete, brick, steel and timber framing, and steel sheeting) and certified by a practicing certified structural engineer in accordance the BCA and Australian Standards.[469]

Building standards which were adopted in the Northern Territory by 1977[470] and introduced in 1982 in Queensland[471] had a significant impact on cyclone resilience.

In contrast to wind events, there are currently no Australian housing design standards for resisting storm tides. The Queensland Government's guidelines on Rebuilding in storm tide prone areas[472] proposes design considerations for improved storm tide resilience to complement existing Australian standards for wind loads.

Private property owners are not prevented from constructing buildings to higher standards than those required under the code, if they wish to increase the building's resilience to natural hazards. There are also privately provided tools (such as the ICA's Building Resilience Rating Tool) which can assist consumers with assessing the resilience of their existing building and inform decision-making processes around any needed resilience measures.

469 City of Karratha, *Guidance note for dwellings and alterations & additions*, June 2014.

470 Darwin Reconstruction Commission, *Darwin area building manual*, Adopted 23 May 1975.

471 Cyclone Testing Station, *CTS Report: TS1004.2, Insurance Claims Data Analysis for Cyclones Yasi and Larry*, July 2015.

472 Queensland Reconstruction Authority, *Planning for a stronger, more resilient North Queensland.*

As Suncorp submits, compliance with the current code does not guarantee a house will avoid severe damage during a major weather event:[473]

- While newer housing stock has greater resilience to environmental hazards, the prevalence of older housing can present a risk more generally. This is due to the potential for airborne debris from older housing to cause damage to neighbouring properties (regardless of age), for example an old style roof or other fixtures coming loose during a cyclone.
- In its submission to the inquiry, Suncorp estimated there are up to 100 000 properties in north Queensland at risk of catastrophic cyclone damage as they were built before the current code, which introduced a higher cyclone building standard.[474] Allianz shared a similar sentiment in its submission noting the efforts to retrofit improvements to bring older properties up to standard would be cost prohibitive and only modest savings would be achievable.[475]
- In Queensland, the Cyclone Testing Station (CTS) at James Cook University conducted a post-event analysis of the vulnerabilities of properties in north Queensland to natural hazards, in particular cyclones and storms. The analysis was informed by policy and claims data provided by Suncorp for this purpose of seeking solutions to decrease the risk from events associated with cyclones. [476]
- One of the key findings showed that properties built in north Queensland prior to the introduction of modern building codes had a higher incidence of structural damage claims in the event of a cyclone.[477] Claims stemmed from weaker points of properties such as large access doors (such as garage doors) not complying or reinforced to standard, lightweight sheds and fences.
- The research also noted that although many of the newer houses tended to have no structural damage from the wind, they encountered wind driven rain issues through weaknesses in the door and/or window surrounds or openings. Importantly, it was noted this issue was not unique to Queensland and similar issues have been observed in northern Western Australia following Cyclone Olwyn.

Suncorp also noted the CTS research had demonstrated that there were significant gaps in the current building standards. For example, it was noted that there is no regulatory specification for fixings of flashing for minimising water ingress (primarily wind driven) around windows and door surrounds.[478] Water ingress was shown to be a major driver of insurance claims following weather events. Further to this, Suncorp also consider the requirements of the code are focused on keeping the underlying structural system intact, rather than protecting contents by, for example, keeping water out of the house.[479]

Storm tide is potentially a very high risk in low lying coastal communities, especially those subject to the risk of cyclones. However, it would be very costly and restrictive to design and construct buildings to resist storm surge because of the significant water forces involved. Restricting development in high hazard areas via planning controls may provide a more realistic solution.

We recognise that the building code is under continual review and this is evidenced by the ABCB work program detailed in its Annual Business Plan 2018–19. We note that the current programme of work includes seeking to address issues related to extreme weather events and other natural hazards. As noted above, weather events that do not affect the structural integrity of a home can nevertheless cause costly damage to a building's interior and contents. The ABCB's ongoing work programme provides an opportunity to consider options for strengthening the building code to reduce the risk of such damage (and resulting insurance claims) in new housing stock.

473 Suncorp submission, p. 19.

474 Ibid, p. 8.

475 Allianz submission, p. 18.

476 Cyclone Testing Station, *CTS Report: TS1004.2, Insurance Claims Data Analysis for Cyclones Yasi and Larry*, July 2015.

477 Ibid, p. 3.

478 Suncorp submission, *Protecting the north—An insurance affordability and cyclone resilience policy proposal*, p. 5.

479 Suncorp submission, p. 19.

Recommendation 15: Building code changes to better protect interiors and contents

The Australian Building Codes Board expressly consider measures that better protect the interiors and contents of residential buildings from damage caused by natural hazard risk (such as, wind-driven water ingress around doors and windows during and following storms).

When assessing the costs and benefits of potential code amendments, the ABCB should also consider the potential longer term impacts on insurance premiums.

13. Where to next

This is the first of three reports that we are required to provide to the Treasurer. Our next interim report will be provided by 30 November 2019 with a final report due at the conclusion of the inquiry by 30 November 2020.

In this report, we set out our findings in detail about the operation of markets for home, contents and strata insurance markets in northern Australia. To inform this, we have drawn on extensive public consultation, and information obtained from insurers not previously available.

We welcome the engagement we have had with the insurance industry, with local communities across northern Australia and the many organisations and groups with an interest in the issues we are considering. This has allowed us to build a detailed understanding of the industry and its operations in northern Australia and also the views and experiences of local communities, which we will continue to draw on as we progress our inquiry.

Throughout the preceding chapters, we have set out a range of measures that could be taken to begin to address the problems we have identified. We urge governments and industry to take quick action on our ***recommendations*** (as set out in section 13.2). We have also proposed a number of ***draft recommendations*** (as set out in section 13.3) that we consider have the potential to make markets work more efficiently. We welcome stakeholder feedback on these proposals

While these measures will bring improvements to insurance markets, it will still leave underlying affordability issues for some individuals that are so sharp that a strong public policy response may be required if northern Australia is to achieve its economic and liveability potential. The key focus of our inquiry in 2019 will be to explore what measures could be considered to improve the affordability and availability of insurance in this region.

We have identified a number of ***focus areas*** for the next stage of our inquiry (as set out in section 13.1). We will use 2019 to explore these areas in a level of detail that has not been possible to date.

13.1 Focus areas for 2019

Importantly, we will broaden the focus of our inquiry in 2019 to consider how issues of insurance affordability and availability have been considered and addressed within Australia and/or internationally, and in relation to other forms of insurance. We will consider proposing policy measures that could have the potential to achieve real and meaningful change for northern Australian communities. This is the objective of focus area one, and our work in this space will be complemented by our four other focus areas which will consider aspects of market dynamics and affordability. This work may lead to us making further recommendations for the government to consider.

Focus area 1: Measures to further improve insurance affordability and availability

We will review options considered in Australia and internationally to improve insurance affordability and availability, and whether these could be applied in northern Australia.

This will enable us to present a broader range of options for governments to consider which have the potential to make a sustainable and meaningful impact on the affordability and/or availability of insurance at an acceptable cost.

Our analysis in chapter 3 confirms that, no matter how measured, the cost of home and contents insurance is higher for those living in northern Australia, and these costs have become more expensive over time. We are aware that the analysis in this chapter does not necessarily reflect the experience of all local residents and property owners in northern Australia. Within postcodes there will be insurance premiums that are considerably higher (and lower) than the average for the area. We propose to undertake more detailed analysis of premiums for home, contents and strata insurance in a number of regions in 2019 to gain a better understanding of where consumers face acute challenges in the availability of affordable insurance products.

Focus area 2: Detailed case studies on sub-regions in northern Australia

We will undertake a number of detailed case studies on parts of northern Australia that face particularly acute availability or affordability issues.

In addition to looking more closely at premium pricing in the area, we will also consider other issues such as claims experience, levels of non-insurance and underinsurance, and the degree of competition in the area.

In chapter 5 we found insurers often made 'premium adjustments' to reflect their broader objectives, not directly related to the risk of a consumer's individual property. These adjustments are not observable to consumers and can result in sharply rising prices in some circumstances. In 2019 we will explore these premium adjustments in more detail to examine how they affect the operation of insurance markets in northern Australia.

Focus area 3: Examination of premium adjustments

We will further examine the use of premium adjustments by insurers operating in northern Australia. In particular, we will consider:

- **the scale of premium adjustments and their potential to distort price signals to consumers regarding risks**
- **the potential impact of adjustments employed to manage concentration risk and exposure, on higher risk consumers**
- **the extent to which insurers are discriminating between new and existing customers through premium adjustments.**

This will help us to determine the extent to which premiums could be lower in northern Australia, and to consider whether there are ways in which the impact of these adjustments on higher risk consumers could be lessened.

In chapter 7, we considered the effect of barriers to entry and expansion that may be preventing insurers from operating in northern Australia. While we found that barriers to entry for an insurer not currently active in Australia would be significant, the barriers facing an existing insurer from entering (or re-entering) northern Australian markets are likely considerably lower. Despite this, and improvements in profitability, there is little indication that such insurers are contemplating this. We want to understand the reasons for this and how the barriers identified could be addressed.

Focus area 4: Identify and investigate barriers to expansion (or re-entry)

We will engage with Australian insurers not currently active in northern Australia to identify and investigate barriers to their expansion (or re-entry) into northern Australian markets.

We consider that for those insurers already operating elsewhere in Australia, barriers to expanding into northern Australia are significantly lower than the barriers for a new entrant to the Australian insurance market. However, some established insurers generally do not write new business in northern Australia.

We will continue to explore, in consultation with insurers, the regulatory and other barriers to expansion into northern Australia. We will also engage on this issue with insurers active in only some regions of northern Australia.

As noted in chapter 1, charities and governments in Australia provide significant amounts of assistance to households and communities who have been adversely affected by natural disasters. High rates of private insurance are socially beneficial, not only in terms of the efficiencies of risk pooling, but also in reducing the reliance on governments (taxpayers) and charities to support the personal hardship that arises when uninsured property is damaged or lost in disaster situations.

We want to further explore the extent and reasons for non-insurance throughout northern Australia. We will also consider what measures insurers have, and could take to make their insurance more accessible to consumers throughout northern Australia. The accessibility of insurance to low income households is a concept we introduced in chapter 9.

Focus area 5: Understanding non-insurance and how it may be addressed

We will explore the extent and reasons for non-insurance throughout northern Australia, including in indigenous communities. As part of this focus area, we will consider current and potential measures to improve the accessibility of insurance to low income households. We will look at the extent to which insurers make Centrepay available to eligible customers and why hardship policies are generally limited to the payment of an excess and not a premium.

This will help us provide a more complete assessment of the accessibility and performance of insurance markets in northern Australia and help guide any other policy responses. Insurance is a 'near essential' product. There are currently very limited obligations on insurers to improve its accessibility to all members of the community and evidence of innovation is lagging other industries. Industry hardship programs are less sophisticated and more limited in accessibility than other industries.

13.2 Recommendations

We will continue to investigate and monitor the industry over the next two years. We will pay close attention to the impact of any changes made in response to these recommendations.

Recommendation 1: Abolish stamp duty on home, contents and strata insurance products

The governments of Western Australia, the Northern Territory and Queensland abolish stamp duties on home, contents and strata insurance products. State and territory revenue needs could be more equitably met through other means.

It has been widely acknowledged that stamp duties on insurance contracts are an inefficient form of taxation. This recommendation is in line with recommendations from previous inquiries into insurance and taxation issues.

Recommendation 2: Re-base stamp duty; use stamp duty revenue for affordability & mitigation

If stamp duties on insurance are maintained, the Western Australia, the Northern Territory and Queensland governments should reduce their burden on consumers in higher risk areas by levying stamp duties for home, contents and strata insurance with reference to the sum insured value, rather than the premium level.

In any case, they should also direct a portion of revenue from stamp duties on insurance products towards measures to improve affordability for low income consumers or to fund mitigation works.

Re-basing stamp duty to be levied on sums insured will make it fairer to consumers living in higher risk areas.

Governments have previously received and continue to enjoy a windfall gain from the growth of insurance premiums in northern Australia. Directing revenue from stamp duties to public mitigation works should only be considered where insurers have provided estimates of premium reductions that would result from such works, and commit to reporting against these where work is undertaken (see recommendation 14).

Recommendation 3: Insurers to report their brands and where they are writing new business

The Insurance Contracts Act should be amended to require insurers to report regularly to ASIC on the brands that they underwrite, and in which postcodes new business has been written for home, contents and strata insurance products.

This will provide greater transparency on which insurers underwrite which brands and assist consumers searching for alternative suppliers in their area. This would build on the Productivity Commission's recommendation in the recent inquiry into competition in the Australian financial system that insurers should provide an up-to-date list of the brands they underwrite to ASIC and that ASIC should transparently publish this information as a list on its website. (PC recommendation 14.2)

Recommendation 4: Standardise definitions of prescribed events

The Treasury's review of the standard cover regime should develop a proposal to standardise the definitions of prescribed events (including 'action of the sea', 'impacts' and 'storm') to enable greater certainty for consumers and comparability of products.

New standard definitions should be drafted in a way that removes potential gaps in coverage between prescribed events, avoids the introduction of ambiguous concepts, and does not unnecessarily limit insurers' scope for future beneficial product innovation.

Recommendation 5: Review and mandate standard cover

The Treasury's review of the standard cover regime should develop a proposal to mandate that insurers offering home insurance/contents insurance products should also offer a home insurance/contents insurance product that does not deviate (through inclusions/exclusions) from the revised standard cover terms in the Insurance Contracts Regulations.

By ensuring there is one common product from each insurer (but not necessarily each brand), consumers could easily benchmark insurers against each other. This should not limit an insurer from offering other products that provide cover that differs from the standard cover product but insurers should be required to clearly indicate how these products differ from their standard cover product.

Recommendation 6: Unfair contract term protections should apply to insurance

The unfair contract term protections in the Australian Securities and Investments Commission Act should apply to insurance contracts regulated by the Insurance Contracts Act.

The government is currently consulting on this change (which it has agreed to in principle).

Recommendation 7: A link to MoneySmart should be on new quotes and renewal notices

The Insurance Contracts Regulations should be amended to require insurers to clearly inform consumers about the Australian Government's MoneySmart website (www.moneysmart.gov.au). A link to MoneySmart using uniform text should be provided on new quotes and renewal notices.

MoneySmart includes information to help consumers understand insurance. This is an important opportunity to raise awareness of the usefulness of this website.

Recommendation 8: Better understand information that falls within 'general financial advice'

The Insurance Council of Australia should engage with ASIC to gain a clearer understanding about the nature and type of information insurers can give to consumers within the meaning of providing general financial advice.

This would ensure that insurers are not refraining from providing general information, for example about rebuilding costs and building valuations, which would assist a consumer make an informed decision about their own situation.

Recommendation 9: Disclose costs that count towards 'sum insured'

The Insurance Contracts Regulations should be amended to require that insurers clearly disclose the types of costs that will count towards the sum insured amount for buildings (such as the costs of demolition, debris removal or for professional fees) where these are not provided for through a separate allowance under the policy. This information should be provided on any sum insured calculators used by the insurer and alongside the sum insured figure.

This will help consumers understand why and how calculator estimations can differ and empower them to make more informed decisions about their nominated sum insured. It should be provided alongside the sum insured amount for a property, including in quotes for new policies, renewals and on certificates of insurance.

Recommendation 10: Disclose the premium, sum insured and excess on a renewal notice

The Insurance Contracts Regulations should be amended to require that renewal notices for home, contents and strata insurance clearly disclose the premium, the sum insured and any excess of the expiring policy. Insurers should also provide this information upon request.

This will allow consumers to easily identify how the insurer proposes to vary these terms from the previous year and seek explanation of any changes.

Recommendation 11: Extend the ban on conflicted remuneration to insurance brokers

The Corporations Regulations should be amended to remove the exemption for general insurance retail products from the conflicted remuneration provisions as they apply to insurance brokers.

Commissions and other benefits given to insurance brokers can give rise to an unacceptable conflict of interest. As is already the case for other financial products, insurance brokers should be prohibited from receiving commissions and other benefits where these create a conflict with a broker's obligation to act in the best interest of their clients. Disclosure alone is insufficient to address these conflicts.

Recommendation 12: Better information for consumers lodging a claim

The General Insurance Code of Practice should be amended to require that at the time a consumer lodges a claim, an insurer or its agent must clearly inform the consumer of the insurer's claim handling policy, and expressly refer to:

- **how the insurer will assess the validity of the consumer's claim**
- **the insurer's preferred repairer policy and in what circumstances a consumer can use their preferred repairer**
- **how decisions are made on cash settlements**
- **who will be managing the claim (for example, the name and contact details of a contracted claims company if relevant)**
- **the fact that the loss adjuster is acting on behalf of the insurer and not the consumer**
- **the consumer's right to make a complaint to the insurer and the Australian Financial Complaints Authority.**

Recommendation 13: ASIC approval for the General Insurance Code of Practice

The Insurance Council of Australia (ICA) work with ASIC to obtain its approval for the General Insurance Code of Practice.

The ICA has indicated in its recent Code of Practice Final Review Report that in order to meet the requirements for ASIC approval it will make a number of changes to the Code. The ICA should work with ASIC to ensure that these changes are sufficient to meet at least the minimum standards in Regulatory Guide 183 to obtain ASIC approval.

Recommendation 14: Public mitigation works and expected premium reductions

The insurance industry should work with governments to identify specific public mitigation works (e.g. flood levees) that could be undertaken and insurers should provide estimates of the premium reductions they anticipate should the works proceed.

Actual premium reductions following such works should also be publicly reported by insurers, measured against their estimates.

Recommendation 15: Building code changes to better protect interiors and contents

The Australian Building Codes Board expressly consider measures that better protect the interiors and contents of residential buildings from damage caused by natural hazard risk (such as, wind-driven water ingress around doors and windows during and following storms).

When assessing the costs and benefits of potential code amendments, the ABCB should also consider the potential longer term impacts on insurance premiums.

13.3 Draft recommendations (for consultation)

There is a board range of stakeholders with a strong interest in our inquiry including local residents and property owners across northern Australia, the insurance industry, regulators, governments, local councils, regional development organisations, brokers, strata management groups and consumer advocacy groups.

Our public consultation to date has allowed us to hear directly from these stakeholders and we would welcome your participation in this next round of consultation that we are opening with the release of this report.

Our draft recommendations are set out below, along with some questions that we seek your views on. These questions are a guide: they are not exhaustive and you may address any issues in your feedback.

We will consider stakeholders' feedback in finalising these draft recommendations in the first half of 2019.

Section 13.4 sets out ***how you can make a submission*** on our draft recommendations. We are requesting submissions by **Friday 12 April 2019**.

Draft recommendation 1: Insurers should estimate a sum insured for customers

The Insurance Contracts Regulations should be amended to require insurers to estimate an updated sum insured for their home insurance customers and advise them of this estimate on their renewal notice.

This estimate should note when the information used by the insurer to form the estimate was last updated by the consumer, and direct the consumer to contact the insurer if renovations/alterations to their home had occurred since then. Where the sum insured estimate is materially higher than provided for under the policy, the renewal notice should also include a warning to the customer about the dangers of their property being underinsured.

- What challenges would an insurer face in calculating these estimates?
- How much higher should a sum insured estimate be before a warning to the consumer is required?
- What would be the implications if a consumer elected to disregard such a warning?

Draft recommendation 2: Prominently publish PDSs and KFSs online with product offerings

The Insurance Contracts Regulations should be amended to require insurers to publish key facts sheets and product disclosure statements online in a prominent manner and alongside the relevant products.

They should be accessible prior to the commencement of a quoting process. This will facilitate more timely and convenient access for consumers to important information about products they are interested in buying.

- Do insurers face any challenges in implementing this? How could these be addressed?
- How prescriptive should such a requirement be in terms of proximity and prominence?
- Is an alternative proposal more appropriate to encourage consumer access and understanding?

Draft recommendation 3: Disclose premium impacts of optional inclusions or exclusions

The Insurance Contracts Regulations should be amended to require that insurers disclose the premium costs or saving for each optional inclusion or exclusion they offer to a consumer. Insurers should also indicate the premium cost or saving associated with incremental changes in excess levels and sums insured. This information should be provided to a consumer with a quote for a policy and upon its renewal.

Providing consumers with information about the cost impact of optional inclusions/exclusions (e.g. flood cover, accidental breakage cover) as well as variable costs (such as changing an excess or sums insured) will allow consumers to make more informed decisions about their choice of cover.

- What challenges do insurers face in implementing this? What are the risks and implications for insurers?
- What are the risks and implications for consumers? Is this too much information that will confuse consumers?
- What increments for sum insured options should be costed?
- Should insurers be required to indicate the cost implications for all standard excess options they offer, or only some?

Draft recommendation 4: National home insurance comparison website

The government should consider developing a national home insurance comparison website. It should require the participation of all insurers active in relevant markets, allow consumers to compare policies by features, and make it quick and easy for consumers to act on the results.

An independent insurance comparison website may facilitate more informed consumer choice by assisting consumers to quickly and easily find insurers in their area and offering policies that meet their needs. Comparison websites can provide an opportunity for new entrants to increase consumer awareness of their brand at relatively low cost, reducing a barrier to entry. Enhanced comparability of products, such as through standardised definitions (recommendation 4) and mandated standard cover (recommendation 5), will assist in the effectiveness of such a website.

- What would be the key advantages and disadvantages of a national independent home insurance comparison website?
- Should the website be limited to home insurance, or should consideration also be given to including contents insurance? What would be the benefits and limitations of a contents insurance comparison website?
- To be effective, is it necessary for the website to provide "live" quotes? That is, does it need to show the consumer the actual quote that they can then automatically proceed with? What would be the benefits and limitations of live quoting? What would be the benefits and limitations of an alternative, such as indicative pricing which could then be tailored to the consumer at the purchase stage?
- Are there are alternate approaches to enabling comparisons between insurance products, for example a rating system?
- Would individual websites developed by state and territory governments be a more effective alternative to a national website?

Draft recommendation 5: Renewal notices should give 28 days notice

The Insurance Contracts Act should be amended to require insurers to provide renewal notices for home, contents and strata insurance no less than 28 days before the expiration of their insurance coverage.

The Insurance Contracts Act currently requires no less than 14 days. The current minimum timeframe does not provide consumers with sufficient time to consider their renewal quote and explore their insurance options. It also may not be sufficient time for some consumers to have ready-access to funds.

- Is 28 days a sufficient amount of time? Would an alternative timeframe be more appropriate?
- Do insurers foresee any difficulties or concerns in providing 28 days?
- Is there a risk that extending this period will increase the chance of a consumer forgetting to renew a policy? What could be done to avoid this risk?

Draft recommendation 6: Disclosure where premium increases are capped

The Insurance Contracts Act should be amended to require insurers that have capped premium increases for particular risks (to slow the rate of adjustment to a higher technical price or other pricing objective), to disclose this to an affected policy holder and provide an estimate of the timing and extent of premium increases that the insurer intends to apply in future.

This will allow consumers to recognise price as a signal of risk and prepare for potential future premium rises.

- What challenges would insurers face in implementing this measure?
- Should this incorporate prescribed wording to ensure consumer comprehension and consistency across all insurers?

- If an insurer adjusts their anticipated technical price, or the timeline for reaching it, how should this be communicated to consumers and at what stage?
- Is there a danger that this information could allow insurers to signal their pricing intentions?

Draft recommendation 7: Consider likely insurance costs before purchasing real estate

States and territories should implement measures to prompt consumers to investigate insurance costs when they are considering purchasing real estate.

As a first step, states and territories should include a statement in a statutory information disclosure for a real estate transaction advising any potential purchaser to obtain an insurance estimate as part of their due diligence.

If recommendation 5 (to review and mandate standard cover) is accepted, states and territories should mandate that a current home (building) insurance premium based on the standard cover product be listed in a statutory information disclosure for a real estate transaction.

This will provide prospective purchasers with a clearer expectation of the possible insurance costs associated with the property.

- What guidance, if any, should be provided on the level of cover that should be used to obtain an insurance estimate (where mandatory standard cover has not been implemented)?
- Are there any unanticipated costs or benefits of this recommendation being implemented?

Draft recommendation 8: Requesting personal information held by insurers

The Insurance Contracts Regulations should be amended to require insurers to provide clear notice to consumers that they can obtain a copy of the information that the insurer holds about them, and contact details for doing so. This notice should be provided on a certificate of insurance and any renewal notices.

This will empower consumers to check and confirm their risk assessment, pricing and claims assessment is based upon reliable and verifiable information.

- Should insurers be obliged to update consumers about any changes in the information that is held about them? For example, if this information changes after a consumer makes a claim against their policy?
- Should the information be provided automatically to the consumer (instead of on request only)?
- Is there an alternative proposal that may be more appropriate?

Draft recommendation 9: Strata managers to be remunerated by body corporate only

State and territory legislation governing strata managers should be amended to prohibit strata managers from accepting payments in relation to arranging strata insurance other than those agreed to, and made by, their body corporate.

Strata managers should be required to negotiate any fees or payments for arranging insurance directly with the body corporate they are servicing. This would encourage remuneration arrangements that better align the interests of the strata manager and their clients.

- What are the potential implications for body corporates or strata managers for this change?
- Should existing contracts be exempt from any changes?
- Is there an imbalance in negotiating power between body corporate committees and strata managers? Will the overall cost of obtaining strata insurance for bodies corporate be reduced?

Draft recommendation 10: Clear disclosure of products considered and remuneration

The Corporations Regulations should be amended to require comparison websites and insurance brokers to disclose a complete list of what home, contents, or strata insurance products they will consider when making a comparison or providing a recommendation to a consumer. If recommendation 3 (insurers to report their brands and where they are writing new business) is adopted, this disclosure should also refer consumers to this information. Finally, comparison websites should also be required to disclose the amount of commission and other remuneration that they receive for each product.

Comparison websites and insurance brokers only consider a sub-set of the market when providing a quotation or recommendations. Consumers should clearly understand the breadth of search undertaken by the comparison website or insurance broker they are looking to use.

- When in the insurance process should this disclosure be provided to consumers?
- Should the wording of the disclosure be left of the comparison website/broker, or be prescribed?
- For comparison websites, should the disclosure require the actual amount of commissions and other remuneration arrangements? If not, what is an acceptable level of detail?
- Should comparison websites also be required to disclose a list of which insurers they will not be considering? Should this be conditional on the adoption of recommendation 3 (for insurers to report their brands to ASIC)?

Draft recommendation 11: Giving consumers more control over how claims are settled

The Insurance Contracts Act should be amended to provide consumers with the right to choose whether their home insurance claim is settled through a cash settlement or by proceeding with a repair/rebuild managed by the insurer.

The consumer must be given clear notice of the implications of accepting a cash settlement, for example the insurer will be discharged of any obligations to manage or guarantee the quality, cost or timeliness of any repair the consumer chooses to undertake. Any ancillary expenses subject to the claim that are not within the scope of works for the quote (such as temporary accommodation costs) would be settled separately.

- What are the risks and implications of this recommendations for consumers? For insurers?
- If a property is subject to a mortgage, does this raise any additional concerns?
- What measure should be used to determine the cash settlement amount? Would it be appropriate for the amount to be equivalent to the insurer's preferred quote?
- Should a consumer be required to obtain independent advice before exercising this option?
- Should the consumer be required to obtain their own quotes for the building repair or replacements?
- What time limit should apply before the decision reverts to the insurer?
- How should any costs already incurred (for example in preliminary works) be accounted for?

Draft recommendation 12: Clearly stated mitigation discounts

The Insurance Contracts Regulations should be amended to require insurer quotes and renewal notices for a property to expressly show what discounts have been applied (if any) to reflect mitigation measures undertaken on that property.

This is important to help ensure premium adjustments are comparable between insurers and transparent for consumers. It also provides clarity to consumers and assists with evaluating investments in mitigation works.

- What are the benefits of detailing mitigation works in quotes and renewal notices as either generalised groups, for example (roof improvements or structural improvements) or specific itemised measures (such as roof replacement, cyclone shutters or cyclone over-battens)?
- Should standard categories of mitigation measures apply across all insurers? If so, what should these be?
- What system challenges (if any) might prevent an insurer from providing greater clarity around pricing of mitigation works?
- Are there any risks of requiring greater disclosure of insurers' mitigation discounts?

Draft recommendation 13: Information on mitigation works that could reduce premiums

The Insurance Contracts Regulations should be amended to require insurer quotes and renewal notices for home insurance to provide a schedule of mitigation measures which customers of the insurer have undertaken for properties with similar characteristics in order to improve their risk rating. This should include a guide to the premium reductions (in percentage terms) that consumers have received for undertaking these measures.

This would provide (new or renewing) consumers with current information on a practical range of actions that could be undertaken to mitigate risk and show them what the benefit could be in terms of premium reductions. This will assist consumers to decide if the risk mitigation option is worth the upfront cost.

- What is the best method for conveying estimates of possible mitigation discounts to consumers? Is there any research or evidence to demonstrate consumers respond better one way or another?
- Should insurers be required to publish their mitigation lists (and/or expected premium reductions) online as well?
- To what extent should mitigation categories and the level of information about mitigation measures be prescribed or, should it be left to insurers to determine?
- What, if any, information should also be provided to consumers on factors to consider before undertaking mitigation works?

13.4 How to make a submission to our draft recommendations

Engagement with all stakeholders, including consumers and communities across the different regions of northern Australia, continues to be very important to our inquiry.

The questions raised with each **draft recommendation** area are only a guide: they are not exhaustive and you do not need to comment on all questions. You also do not need to comment on all draft recommendations and all focus areas.

Please email submissions to insurance@accc.gov.au by Friday 12 April 2019.

This inquiry is a public process, so responses will ordinarily be published on the ACCC website as submissions to the inquiry. This is important to facilitate a transparent and robust consultation process.

- If you are making a submission as an **individual** (such as local resident or property owner), you may request that we do not publish your name. If you do not want us to publish your name, you must clearly tell us. Otherwise we will publish your name with your submission.
- If you are a **business or organisation**, we will generally publish those details. The Competition and Consumer Act does, however, allow interested parties to make claims for confidentiality over written feedback in certain circumstances. Please refer to section 13.5 Treatment of information for further information.

If you are sharing your experience, please be specific about your geographic location (suburb, town, or region), the type of insurance product you are referring to (i.e. home, contents or strata) and the insurer/s you are referring to.

We request that you provide your submission in electronic form, either in PDF or Microsoft Word format, which allows the submission to be text searched.

If you are unable to make a written submission, we can arrange a time to call you to take an oral submission by telephone.

Our contact details

Telephone: ACCC Infocentre 1300 302 502

Email: insurance@accc.gov.au

Post: ACCC Northern Australia Insurance Inquiry, GPO Box 520, Melbourne, VIC 3001.

Webpage: www.accc.gov.au/insurance

13.5 Treatment of information

We prefer that all submissions are publicly available, to facilitate an informed, transparent and robust consultation process. Submissions be published on the ACCC website, unless we have accepted a claim for confidentiality.

The *Competition and Consumer Act 2010* allows interested parties to make claims for confidentiality in certain circumstances. We invite parties to discuss confidentiality issues with us in advance of providing written feedback.

Any information that parties would like to claim confidentiality over should be provided in a separate document and should be clearly marked as “confidential” on every page. Reasons must be provided in support of the claim for confidentiality, so that we can properly consider whether the claim is justified.

The ACCC can accept a claim of confidentiality if the disclosure of information would damage a party’s competitive position. If we are satisfied that the confidentiality claim is justified, we must keep that information confidential unless we consider that disclosure of the information is necessary in the public interest.

If the ACCC considers that the confidentiality claim cannot be upheld, we will provide the party with an opportunity to withdraw part or all of their feedback. If a party elects not to withdraw the information then we may disclose the information publicly.

If the ACCC subsequently considers that disclosure of the information that has initially been treated as confidential may be necessary in the public interest, the ACCC will consult with the party providing the information, before any such disclosure is made.

For further information regarding our use and disclosure of information provided to us, see the ACCC & AER information policy, which is available on our website at:
www.accc.gov.au/publications/accc-aer-information-policy-collection-and-disclosure-of-information

Appendix A. Notice from the Treasurer

COMMONWEALTH OF AUSTRALIA

COMPETITION AND CONSUMER ACT 2010

INQUIRY INTO THE SUPPLY OF INSURANCE IN NORTHERN AUSTRALIA

I, Scott Morrison, Treasurer, pursuant to subsection 95H(1) of the *Competition and Consumer Act 2010*, hereby require the Australian Competition and Consumer Commission to hold an inquiry into the supply, by persons in the insurance industry, of residential building, contents and strata insurance products ("insurance") to consumers in northern Australia.

Matters to be considered by the inquiry shall include, but not be restricted to:

i. the pricing and availability of insurance to consumers in northern Australia;

ii. the key cost components of insurance pricing in northern Australia and how they have changed over time, particularly catastrophe risk;

iii. the terms and conditions on which insurance in supplied;

iv. the competitiveness of markets for insurance in northern Australia;

v. the existence and extent of any barriers to entry, expansion and/or exit in the supply of insurance in northern Australia;

vi. any impediments to consumer choice, including transaction costs, a lack of transparent information, or other factors;

vii. identifying any regulatory issues, or market participant behaviour or practices that may not be supporting the development of competitive markets for insurance in northern Australia; and

viii. the profitability of insurers through time and the extent to which profits are, or are expected to be commensurate with risk.

To inform its inquiry, the ACCC should monitor the activities of the insurance industry in northern Australia for a period of three years, commencing on 1 July 2017.

Northern Australia means the area defined has the meaning given in section 5 of the *Northern Australia Infrastructure Facility Act 2016*.

The ACCC should make use of publicly available information on the insurance industry, including that published by the Australian Prudential Regulation Authority, where appropriate.

This is not to be an inquiry in relation to supply by any particular person or persons.

The inquiry is to commence on 1 July 2017. The ACCC is to submit interim reports to me by 30 November 2018 and 30 November 2019. The inquiry is to be completed and a final report submitted to me by 30 November 2020.

DATED THIS 25th DAY OF May 2017

SCOTT MORRISON

Treasurer