Senate Economic References Committee

Inquiry into Australia's General Insurance Industry

Opening Statement

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Australia's general insurance industry

Terms of Reference

On 22 November 2016, the Senate referred the following matters to the Senate Economics References Committee for inquiry and report by 22 June 2017:

a) the increase in the cost of home, strata and car insurance cover over the past decade in comparison to wage growth over the same period;

b) competition in Australia’s $28 billion home, strata and car insurance industries;

c) transparency in Australia’s home, strata and car insurance industries;

d) the effect in other jurisdictions of independent home, strata and car insurance comparison services on insurance cover costs;

e) the costs and benefits associated with the establishment of an independent home, strata and car insurance comparison service in Australia;

f) legislative and other changes necessary to facilitate an independent home, strata and car insurance comparison service in Australia; and

g) any related matters.

Opening Statement – Rob Whelan

Thank you for the opportunity to give evidence and provide this opening statement to the Committee on behalf of Australia's General Insurance Industry.

The Insurance Council of Australia is the representative body of the general insurance industry in Australia, including those insurers who offer home, strata and car insurance.

I start by looking at the industry's views on the key themes of this inquiry.

Transparency

My organisation welcomes the Committee's focus on transparency.

The Insurance Council is committed to achieving improved outcomes for consumers buying general insurance. It offers an award-winning financial literacy tool Understand Insurance and the free Find an Insurer consumer referral service, which operates through a call centre as well as online and reaches hundreds of thousands of consumers each year.

Effective Disclosure has been a priority project for the industry over the past two years.

As outlined in the submission, the Insurance Council has released findings of large-scale consumer research on product disclosure and pre-purchase behaviours. This ground-breaking research, which explores consumer buying behaviours, confirmed policy coverage consistently falls behind price as a driver of product selection. It follows an industry-commissioned taskforce report that concluded the legally required Product Disclosure Statement, which was intended by the then-Howard Government as the best way of informing consumers, often does not effectively serve its purpose and other forms of disclosure should be explored.

Though I am enthusiastic about the next steps for the insurance industry's Effective Disclosure project, the Insurance Council is concerned the focus on comparator websites through this inquiry could detract from the broader aims of this industry-led work.

For example, as part of the next phase of the disclosure project, the Insurance Council is conducting an industry review of product comparability options to identify methods of improving consumer understanding of the coverage differences between products on the basis of customer needs, product value, and not just price.

It is intended that this research will be a shared industry resource to inform individual insurers trialling new and innovative disclosure tools and techniques to better support insurers.

In contrast, comparator websites will lead to adverse consumer outcomes. The design and natural price focus of comparison services often results in the purchase of a product that is not necessarily suitable to needs. A focus on price without due consideration for policy coverage will put consumers at risk of underinsurance and expectations of a gap may occur if a claim is made. These concerns are supported by many of the submissions to the Inquiry, including APRA and credible consumer groups. ASIC, too, has previously expressed its concerns about price comparison websites.

Comparison websites may be acceptable for simple products, such as petrol or interest rates or groceries, but insurance products are not the same. They vary widely in product features, inclusions, exclusions and claim limits. Each insurer has different underwriting criteria and different risk appetites. Each insurer assesses the risk to a property in much different ways. And data enables an insurer to update its risk analysis frequently. This is a necessary feature of the market and makes the delivery of an up-to-date, accurate comparative site extremely difficult and complicated to deliver.

Further, the experience with these websites in similar markets, most notably the UK, has been to the detriment of consumer choice, competition and product choice. If consumers do not understand the policies they are buying, it can result in major financial losses and angry customers. It may also cause reputational damage for the industry and lead to fewer householders choosing to buy insurance to protect their assets, or to be properly insured. This leads to further burdens on governments and charities. This must be avoided and the industry disclosure work allows us to take a significant step forward.

I am aware of some submissions that refer to a Norwegian price comparison website as a possible model. However, the Insurance Council has examined this site and the official report into its effectiveness. In terms of encouraging consumer interest in comparing policies, the site is expensive to construct and maintain and has had little demonstrable impact on consumer decision-making.

Competition

I refer now to competition. In relation to competition, the Government’s Financial System Inquiry, APRA and the Australian Treasury have all found that the level of competition in the industry is strong. The Insurance Council’s general assessment of concentration in the industry - as set out in the submission - is consistent with those findings. There are some 105 APRA licensed insurers operating in Australia across a wide variety of policy types. In 2015-16 there were 44 million policies in force with 3.7 million claims lodged with 97 per cent of all claims paid.

The industry is one of the most highly regulated in the world. It is prudentially managed to a level seen in few other jurisdictions, and premiums reflect a number of inputs including risk. Insurers compete on product range, product features and also on price.

Over the past 15 years, home and strata insurance premiums have increased at higher rates relative to wage growth. However, over the past two years, home and strata insurance premiums have remained broadly unchanged. Premiums for motor vehicle insurance have been little changed for many years now.

It is important to recognise that changes in insurance premiums and wages are also driven by different factors. Trends in wages growth in Australia reflect, for example, increased spare capacity in the unskilled and semi-skilled labour market, a decline in expectations of future consumer price inflation and a lower terms of trade and consequential fall in mining investment.

Premiums, on the other hand, must cover the costs of claims, taxes, levies and stamp duty, reinsurance, internal expenses and margins. Insurers must also set aside enough regulatory capital to meet the strict prudential capital requirements set by APRA.

As detailed in our submission, increases to premiums for home insurance demonstrate this and have been driven by factors including:

- a series of natural disasters, which have cost insurers more than $7 billion in Queensland alone

- higher claim volumes
- costs
- higher asset values and sums insured amounts
- higher rebuilding costs including transport, products and specialised labour
- significant changes to the regulatory and prudential requirements such as introduction of a common definition of flood and an overall 2 per cent increase in regulatory capital.
- higher global reinsurance costs
- and the introduction of new product features to benefit consumers, including the availability of flood cover to all households and businesses since 2011.

Most of these factors are, in fact, beyond this industry's control.

I will conclude my remarks by outlining the work of the industry to tackle insurance affordability in high-risk areas.

The Insurance Council has strongly advocated for disaster mitigation funding and improved resilience by participating in a number of federal and state reviews. The industry agrees with the Northern Australia Insurance

Premiums Taskforce and the Productivity Commission that mitigation is the only way to reduce premiums on a sustainable basis.

The Insurance Council was disappointed the Government's response to the Productivity Commission's report on Natural Disaster Funding did not take up the recommendation to increase mitigation funding to $200 million a year matched by states and territories.

Today, in the aftermath of Cyclone Debbie, the case for urgent investment in permanent, well-designed mitigation for disaster-prone communities cannot be clearer.

Where mitigation does not exist or poor decisions were made about the design, floods have proved devastating. Insurers have to price the risk of these events, and where the risk is high so too are the premiums.

In some respects insurance is the canary in the coal mine. Premiums alert individuals and governments about the high risks of living in certain areas. These signals should spur action in the form of mitigation and resilience measures, better town planning to prevent inappropriate development, and improvements to building codes.

I therefore welcome recent statements by the Federal Opposition Leader Bill Shorten committing to fund mitigation in Rockhampton. This is a positive step towards recognising the need for these investments.

However the Insurance Council believes mitigation and resilience should have bipartisan support, and urges the Federal Government to join state and local governments in identifying, then making provision for, mitigation projects across Australia. This is one form of nation building that would have a lasting positive impact.

In a jurisdiction that faces similar perils to those experienced in Australia, the Canadian Government has in their 2017 Budget allocated $2 billion to create a Disaster Mitigation and Adaptation Fund, which demonstrates increasing support for disaster risk reduction in that country.

Government intervention in the market to artificially discount premiums masks the true risk to be underwritten and would not solve the problem of at-risk communities. Indeed experience in other jurisdictions such as the US has shown that such intervention can actually exacerbate the problem by providing a false sense of security encouraging more inappropriate development in high-risk areas.

The consequence of inaction is community devastation and hundreds of millions of dollars being spent by governments on disaster recovery, which has no impact on the underlying problems.

Though the cost of Cyclone Debbie will take a long time to be tallied, insurers are paying out $2 million a day in emergency repairs and accommodation and expect insured losses will total more than $660 million. The cost to governments in disaster relief funding, loans and subsidies as well as replacement of major infrastructure could easily outstrip this amount. The pattern where 97 per cent of government disaster funding is expended after an event ignores the overwhelming evidence of the massive economic benefit of funding prevention where $1 spent on prevention can save up to $10 on recovery.

I am happy to take questions from the Committee.

ENDS