



SUBMISSION TO THE TREASURY DISCUSSION PAPER - ADDRESSING THE HIGH COST OF HOME AND STRATA TITLE INSURANCE IN NORTH QUEENSLAND



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EXECUTIVE SUMMARY

- Insurers operating in North Queensland (NQ) have raised premiums in response to a confluence of factors. These include a higher frequency of natural peril events, and a related rise in the cost of re-insurance and claims, at a time of significant improvement in data availability and the capability of insurers to interpret and apply it to household pricing.
- IAG does not support the introduction of a price comparison site as we believe this would not address the underlying drivers of insurance affordability, accessibility and participation. And it would not address the underlying driver of the price increases experienced by some NQ property owners — the premium restructuring process that is unwinding cross subsidies from low to high-risk policy holders. However, if the Government is intent on the introduction of a price comparison site, IAG welcomes the opportunity to work with Government and other stakeholders on the development of the most appropriate options to achieve the social and economic policy objectives, and to support a move towards a more sustainable and comprehensive approach to addressing the cost of home and strata title insurance in NQ.
- While IAG believes a price comparison site will not bring down the prices in NQ, the Victorian Fire Services Levy (FSL) monitor type comparison site (static, 'point in time' quotes) with additional consumer information provides an example of a workable model. We believe this model is the least costly and least disruptive (of the comparison website options proposed) for the functioning and sustainability of the NQ insurance market.
- Fundamentally, a 'live-quote' aggregator would not facilitate effective consumer decision making through the provision of genuine comparisons to assist choice. Additionally, implementing a 'live-quote' aggregator site would have major cost implications for insurers and potentially place the long-term sustainability of the industry at risk.
- On a practical level, a 'live-quote' website would be near impossible to implement for home insurance. Necessary process changes would include data mainframes, employee-facing front-end systems, internet sales processes, employee training, underwriting technology and process changes, and rating engine changes. Even if a set of questions across the industry could be provided to capture some of this information, customers could not rely solely on the responses to obtain a comprehensive view of a building's risk attributes.
- It is not possible to price strata insurance on an aggregator site. Strata insurance is an intermediated product by nature; it is not available to the average consumer via the internet or over the phone. Moreover, it would displace brokers, and remove from bodies corporate the advantage of having an insurance expert provide advice on relevant products as well as leveraging policies across multiple bodies corporate and associated discounts.
- A 'live-quote' aggregator site has high potential for perverse economic and social outcomes that are counter-productive to the government's goal of reducing premiums through greater transparency and higher market participation. Moreover, there is a risk that a 'live-quote' website would increase the scope for cherry picking of lower risk customers rather than addressing the affordability challenges faced by customers in the highest-risk areas.
- It is not possible to overlay individual customer discounts, rewards or loyalty programmes — which can change a price by up to 25% as part of a multi-policy discount and/or 25% with a no claim bonus — via a 'live-quote' comparison website. This variation is critical to each insurer's underwriting model, product variation and ultimately their ability to compete.
- While the UK experience has been considered to be a good case study for aggregator effectiveness, it is important to note that the UK doesn't share Australia's propensity for catastrophic weather events such as cyclones and bushfires. Moreover, Australian insurers price at a household level and offer bespoke policy coverage; in the UK, peril pricing is not at the granular level Australian insurers have implemented. This model lends itself to an aggregated insurance market, whereas Australian circumstances do not.

EXECUTIVE SUMMARY (CONTINUED)

- Most strata insurance in NQ is sold by insurance brokers, who assist consumers with their purchasing decision and negotiate with insurers to provide risk information which in turn leads to insureds receiving optimum cover at the best price. Limited insurer participation in the NQ strata market also renders an aggregator site ineffective.
- If unauthorised foreign insurers are permitted to operate with relaxed restrictions consumers remain inappropriately exposed. IAG believes all providers of insurance products should be required to meet the APRA prudential and reporting standards. If unregulated foreign insurers are not subject to the same prudential regulations as Australian-licensed insurers, there is potential for them to not exhibit the same loyalty to the Australian market, creating questions for policyholders over whether their insurer will be operating here when the time comes to pay their claims.
- IAG notes the short and long-term effectiveness of the current CGU/SUU strata building/engineering assessment project in identifying risks and making repairs, with a view to reducing risks and insurance premiums. IAG believes this work is best undertaken by the private sector. We note however, there are significant opportunities for the government to assist with improved catastrophe modelling or a best practice guide on to construct and maintenance of buildings.
- IAG believes the removal of all state taxes and duties on insurance products sold in Australia is an important first step in addressing insurance affordability, accessibility and participation. In this context, the immediate removal of taxes and duties on mandatory products such as strata insurance, presents the most expeditious and effective means of bringing immediate premium relief to NQ.
- The most effective way to address longer-term insurance affordability, accessibility and participation in NQ is through a nationally coordinated and well-resourced disaster resilience program that reduces the impact of extreme weather events. IAG supports a co-ordinated and collaborative national approach, involving the three levels of government, community and insurers, to managing the impact of natural disasters on the community.
- Other options that should be considered in addressing insurance affordability, accessibility and participation include the development of bespoke insurance products that provide cover only for specific peril events, and micro-insurance.

INTRODUCTION

Insurance Australia Group (IAG) welcomes the opportunity to make a submission to the Treasury *Discussion Paper — Addressing the high cost of home and strata title insurance in North Queensland*. The affordability of and access to insurance in North Queensland (NQ)¹ is an important challenge for the Australian insurance industry.

IAG recognises that the pace with which premiums have risen has caused consumer concern and recognises that, as an industry, we have not educated consumers well enough on the value of insurance, how insurance is calculated, and the drivers of premium increases in NQ.

A range of measures to address affordability, accessibility and participation have been raised, including an industry or government ‘aggregator’ mechanism. IAG does not believe a ‘live-quote’ aggregator site for home or strata insurance would address the underlying driver of premium increases experienced by some NQ property owners. However, we believe other solutions are available which will deliver premium reductions as well as address concomitant issues of accessibility and participation.

This submission outlines a range of proposals IAG is currently working on which we are confident can address the insurance affordability, access and participation challenge in NQ. IAG looks forward to working with the government and other stakeholders on the development of the most appropriate options to achieve the social and economic policy objectives, and to support a move towards a more sustainable and comprehensive approach to addressing the high cost of home and strata title insurance in NQ.

¹ For the purposes of discussions, NQ is defined in line with the definition employed by the Government Actuary for his 2012 and 2014 analysis of the NQ strata insurance market, which was limited to the Marlborough region around Rockhampton, together with areas in and around Mackay, Proserpine, Townsville, Ingham and Cairns.

INSURANCE AUSTRALIA GROUP

IAG is the parent company of a general insurance group with controlled operations in Australia, New Zealand, Thailand and Vietnam, employing over 13,500 people (8,759 are in Australia). IAG has more than 762,000 shareholders. IAG's share register is the fourth largest in Australia. IAG is a top 30 ASX-listed company.

IAG's current businesses underwrite approaching \$10 billion of gross written premium (GWP) per annum, selling insurance under many leading brands including NRMA Insurance, CGU, SGIO, SGIC and Swann (Australia); NZI, State and AMI (New Zealand); Safety and NZI (Thailand); and AAA Assurance (Vietnam). IAG also has interests in general insurance joint ventures in Malaysia, India and China. Standard & Poor's has assigned a 'Very Strong' Insurer Financial Strength Rating of 'AA-' to the Group's core operating subsidiaries.

Across IAG's portfolio of brands, IAG insures 8.4 million cars, 2.9 million homes, 103,000 farms, 123,000 employers and 408,900 businesses. IAG had more than 16.1 million policies in force in financial year 2013.

At 30 June 2013 the Group's overall investment allocation remained conservatively positioned, with 86% of total investments in fixed interest and cash (rates of 'AA' or higher). At that date, the Group had:

- total investments of \$13.6 billion;
- technical reserves of \$9.4 billion backing insurance liabilities, invested in fixed interest and cash; and
- shareholders' funds of \$4.2 billion

IAG has considerable business in NQ. IAG's CGU Insurance and NRMA Insurance businesses account for between 10% and 15% of the home insurance products sold in NQ. CGU's wholly-owned subsidiary Strata Unit Underwriters (SUU) accounts for around 50% of strata insurance sold in NQ.

THE NORTH QUEENSLAND INSURANCE MARKET

Regulatory compliance and North Queensland

The NQ insurance market represents just 6% of the Australian property insurance market. The introduction of regulatory measures to address the concerns of insurance affordability and accessibility in the region would impose additional compliance requirements. These would add to the compliance and administrative costs incurred by insurers. Such measures would be short-sighted, counter-productive, and at odds with other reviews being undertaken by the Federal Government, such as the Financial Systems Inquiry and the Competition Policy Review, which seek to remove unnecessary red tape and reduce the current compliance costs of doing business in Australia.

Historically, Australian governments have recognised that efficient and effective regulation is necessary and desirable to facilitate the smooth functioning of the economy and to ensure that social, economic and environmental aims are achieved. However, excessive, poorly-designed and overlapping regulation places a significant cost burden on Australian businesses and consumers. Governments should not act to address 'problems' through regulation unless a case for action has been clearly established. Moreover, any regulatory or legislative response should be proportional to the issue or 'problem' being addressed.

Insurance premiums in North Queensland

While NQ has long been exposed to natural hazards, the frequency of extreme weather events and their level of destruction have risen significantly over the past eight years. Some of the more significant events include: Tropical Cyclone (TC) Larry (2006); TC Yasi (2011); storms and floods following TC Oswald (2013); and the Mackay Floods (2008). Added to this, despite its small market share, Queensland has been the source of significant claims pay-outs by insurers (the total cost of major events over the past eight years is approximately \$3.4 billion). In NQ, the cost of cyclone makes up 48% of an average premium in the vicinity of \$642. This reflects the high risk of tropical cyclones the community faces in that region.

The Insurance Council of Australia (ICA) notes that due to its high incidence of natural perils, Queensland, as a state, benefits from insurance arrangements to a greater extent than other states, i.e. Queenslanders account for a greater percentage of national claims than they contribute to national premiums. In the five years to June 2010, for all property classes, Queensland drew some 25% of national claims despite contributing around 15% of premium into the premium pool. By contrast, NSW, which contributed some 40% into the pool, drew under 35% in national claims. APRA data for FY 2013 shows that Queensland has incurred the highest percentage of claims cost for homeowners. Where NSW paid 38% of premium in claims costs, Queensland paid 59%.

Home insurance

There are many factors which have contributed to increase pressure on insurance premiums in NQ. Reinsurance costs are considerably higher than they were several years ago in response to the unprecedented spate of natural perils across the country, specifically in NQ (reinsurance costs are driven by many factors, including the frequency and cost of natural disasters. Reinsurers concentrate on natural catastrophe type events, both in Australia and internationally). This in turn has added a cost to selling insurance. Other key premium drivers include building and repair costs, particularly in regional areas. It is important to note that building codes only address structural integrity not the durability of property to extreme weather, meaning the cost of damage can be high.

THE NORTH QUEENSLAND INSURANCE MARKET (CONTINUED)

An important driver of recent price increases for insurance in NQ has been insurers more closely aligning their premiums with risks — an alignment that is desirable if insurance is to play a useful price signalling role. While this realignment has been occurring across Australia, this process is inevitably having a pronounced collective effect in NQ. In effect, the observed premium increases have occurred off a subsidised price base, with previous artificially low premiums on the many higher risk properties in the region paid for by other customers, the majority of whom resided outside of NQ. It is important to note that while this premium realignment process is leading to higher insurance costs for NQ customers as a whole, insurance should become more affordable than would otherwise be the case for those North Queenslanders living in lower risk properties.

Significant improvements in data availability and interpretation capability are allowing larger insurers to assess an individual customer's personal circumstances to ensure their premium reflects the risk. This takes into consideration a property's exposure to events like cyclones and storms. Household pricing recognises and rewards customers as individuals, each with their own risk profile, instead of treating them as a postcode, demographic group or risk factor. This means pricing is increasingly more granular and dynamic.

There is significant moral hazard involved with customers at very low risk or zero risk subsidising the costs of those with high risk. The vast majority of the community have no exposure to hazards such as flood or cyclone at all and do not feel they should cross-subsidise the risks of others. Additionally the price would not reflect the risk. Moreover, the price of insurance premiums provides an important signal that can help individuals and communities make decisions about property development and risk management. Any distortion of this signal through community rating, or hidden subsidies, will militate against good risk management, and act to discourage product innovation by insurers.

Strata insurance

The value of a strata building is higher than a home, so the scale of losses is potentially higher. Many strata buildings are situated in areas of high risk i.e. next to the coast and built for their sea views or holiday letting. This puts them at higher risk of cyclone damage than properties inland. Strata risk is more concentrated — as opposed to insuring 100 homes spread over a city, a strata building might present 100 homes on the same small square footage. So if a storm hits that particular area it could lead to a higher number of insurance claims in terms of value, than if that risk was spread across a geographical area. On average, strata properties are subject to more loss than houses and experience a higher claims frequency — strata insurers report claims frequencies of up to 30% compared to an average of 10% in residential home portfolios.

Competition in the North Queensland Home Insurance Market

Insurance pricing in NQ reflects the underlying risk of loss as well as the prudential standards (capital requirements) required of Australian-licensed insurers to ensure consumer protection is maintained. Some insurers do not offer home insurance in NQ due to the high risk, while those who sell insurance do so at a price that reflects the risk. Until recently, insurance premiums have not reflected the true risk of extreme weather events. While the cost of premiums has risen in recent years, the price is now reflective of the increased risk. IAG businesses insure all regions in Australia (including NQ), irrespective of the certainty or otherwise of risk in the region.

While there is less competition in the NQ home insurance market than in several other parts of Australia, this market is still for the most part competitive and contestable. Several insurers offer

THE NORTH QUEENSLAND INSURANCE MARKET (CONTINUED)

home insurance products in NQ with a reasonable level of competition (notwithstanding the red-lining approach to NQ employed by some insurers). Evidence from research commissioned by IAG (Sapere 2012) indicates that many of those purchasing or renewing home insurance do shop around and thereby exert competitive discipline on insurers.

The NQ strata insurance market is less competitive. The Australian Government Actuary in his 2012 report that the strata insurance market is shallow due to the departure of several market players. Still, the Australian Government Actuary also noted “While it is true that there is limited competition in the NQ strata title insurance market, it is not clear that this has resulted in prices which are unreasonably high when assessed against the underlying risk”. And as noted in Treasury’s 9 March *Discussion Paper*, “a lack of competition need not, however, be a driver of higher prices”.

It is important to note that general insurance markets in Australia are considered by industry experts to be competitive and dynamic, with ever-increasing transparency of pricing and policy features². This can be seen in the steady increase of market share by the new challenger brands to the personal insurance market including, Auto and General, Hollard, Coles, Youi (part of Rand Merchant Insurance Holdings Group) and Progressive. UBS reports a greater than expected market share swing to these companies in home and motor insurance³. Furthermore, the personal insurance market is one where consumers can easily shop and switch products. In 2013, 57% of policies were switched in Queensland due to finding a better priced premium. A further 23% of consumers switched providers because ‘the renewal price was higher than last year’ and 13% of consumers stated that ‘they always shop around’⁴.

Insurance taxes

IAG believes the removal of all State Government taxes and duties on general insurance products sold in Australia is an important first step in addressing insurance affordability, accessibility and participation. Currently, there is an anomaly with statutory classes of insurance, with workers’ compensation and CTP exempt from stamp duty, while mandatory cover such as strata insurance is subject to taxes and duties of 10% in Queensland. In this context, immediate taxation relief on NQ insurance products, particularly mandatory products such as strata insurance, presents the most expeditious and effective means of bringing immediate premium relief to NQ.

² KPMG 25th General Insurance Industry Survey 2011

³ UBS Investment Research, Australian Insurance Sector Update, October 2013

⁴ Roy Morgan Research, December 2013

INSURANCE AGGREGATORS

Home insurance comparison websites and insurance affordability

IAG does not support the introduction of a price comparison site as we believe this would not address the underlying drivers of insurance affordability, accessibility and participation. And it would not address the underlying driver of the premium increases experienced by some NQ property owners — the premium restructuring process that is unwinding cross subsidies from low to high-risk policy holders.

The price of insurance premiums provides an important signal that can help individuals and communities understand their exposure to a range of risks and provide an incentive to implement preventative and protective measures to reduce their vulnerability. Any meaningful and effective policy response must go beyond insurance and also focus on prevention. More insurance products will not prevent natural disasters from occurring in the future.

However, if the Government is intent on the introduction of a price comparison site, IAG welcomes the opportunity to work with Government and other stakeholders on the development of the most appropriate options to achieve the social and economic policy objectives, and to support a move towards a more sustainable and comprehensive approach to addressing the cost of home and strata title insurance in NQ.

Home insurance comparison websites in Australia

Consumers are becoming more proficient in their online product research. The availability of online information on insurance is readily available and continues to grow — ranging from insurer's own websites, consumer and expert blogs and chat rooms, to commercially-owned comparison websites⁵.

Insurance comparison websites, such as Canstar and Choice, provide an effective service that compares product features across multiple insurers. Furthermore, insurance brokers play an important role in reviewing products across a range of insurers and assisting consumers to obtain the most suitable coverage for their needs. Most strata insurance in NQ is sold through insurance brokers, who assist consumers with their purchasing decision and negotiate with insurers to provide risk information which in turn leads to insureds receiving optimum cover at the best price.

The recent One Big Switch (OBS) campaign demonstrated that insurers need to price sustainably based on an individual risk profile and this principle does not change, regardless of the amount of information made available to consumers. OBS also showed that information asymmetry is not the cause for higher insurance premiums in NQ and that NQ is a high-risk weather environment. OBS was acting as a broker or insurance comparison vehicle by comparing insurance offerings and selling Coles insurance, one of the more aggressive price competitors in the market.

Possible further development of home insurance comparison websites in Australia

The overall benefit of comparison websites to consumers is highly debatable. Leading consumer advocate *Choice* describing aggregators as 'potentially misleading' in its 2013 'Review of Insurance Comparison Sites' and singled out the practice of only listing the products sold by companies who paid a commission. Regulators have also expressed concerns about aggregators. In 2012, ASIC issued a warning on comparison advertisements featuring products with insufficiently similar product attributes and opaque awards or product ratings.

⁵ Swiss Re, Digital Distribution in Insurance, A Quiet Revolution, March 2014

INSURANCE AGGREGATORS (CONTINUED)

A comprehensive comparison website should have an element of independence (i.e. administered by an industry regulator such as ASIC) and focus on product coverage/features. A rating of the insurer's claims service would also be a useful comparison tool for consumers. A comparison website that distinguishes products on price alone is misleading to consumers. ASIC in Regulatory Guide 234 *Advertising financial products and advice services: Good practice guidance* identified a number of concerns with comparisons websites, including comparisons that were based on price alone without any warning of the different product features and levels of coverage.

Challenges with home insurance comparison websites in Australia

Home and/or contents insurance in NQ includes (but is not restricted to) private residential properties in regional centres, properties owned by an investor for rental (an increasing number), holiday homes, and homes on farming or primary producing properties. Each one of these types of risks is likely to be insured by three discrete and different insurance product offerings: home and/or contents; landlords; or farm/home policies. Each of these policies leads to significantly different risks and, as a result, a different risk and price assessment criteria. Even though there is common information, there are unique factors to each product offering. The diversity of risks insured within each of these segments can vary significantly - holiday homes, transportable homes, permanent on site accommodation within caravan parks, nursing homes, and (increasingly) combined home and business risks.

Underwriting and pricing questions are not consistent across the Australian insurance industry. Each insurer has its own underwriting appetite of acceptable risks and relies on a unique set of underwriting and pricing questions that enable it to confirm the availability and the terms of the cover it provides. Insurers look to provide transparent and reliable responses to current or potential customers and, as a result, insist on having their underwriting and pricing questions fulfilled.

Even if a set of questions could be provided for the insured to capture some of this information, insurers could not rely solely on the responses to obtain a comprehensive view of the building's risk attributes because a) the list of questions that we would need to ask would be extremely lengthy and cumbersome for an insured to complete; and b) many questions that are intended to act as an indicator of potential risk issues that then require further analysis by an underwriter. Also, many if not most strata risks have some form of inherent defects or degradation, requiring further discussions and consultations with relevant experts.

Due to variations in business models, cover and pricing, it is difficult for online aggregators to accurately and fairly make "like with like" product comparisons. Aggregators tend to provide a limited number of policy coverage comparison points. Providing simplistic and inaccurate comparisons means consumers are less inclined to research the different products available to them that suit their personal circumstances. As a consequence, consumers can miss out on coverage options that suit their personal needs. Consumers also risk missing out on relevant discounts available to them, along with the ability to choose the level of excess suitable to their personal circumstances which could reduce premiums up to 20%.

Typically, insurers use additional analytical tools, resources and risk data to understand the risk attributes of a property. For example, we use RP Data to determine building attributes such as year of construction which is an important factor in understanding vulnerability of property to cyclone. We do this to ensure a thorough understanding of the property and to minimise unknown risks that if not discovered prior to time of claim, could be considered a non-disclosure event. Moreover, in the strata

INSURANCE AGGREGATORS (CONTINUED)

insurance context when insurers assess risks in highly-exposed regions, they look at adjoining properties and review to what extent our insured properties may be buffered by other infrastructure. Collection of this information is not possible via a question set alone.

Aggregators do not help consumers understand the product they are purchasing or the differences in the products offered by different insurers. Rather, aggregators provide a limited number of policy coverage comparison points. Simplistic and inaccurate comparisons on insurance policies means consumers are less inclined to research different products available to them that suit their personal circumstances. For example, in a home insurance policy, there are numerous choices available through different policies at different prices. Individual policies vary depending on a variety of factors include:

- Type of insurance (i.e. home building, home contents or combined home and contents);
- Level of cover (i.e. standard home insurance or Home Plus, which provides a higher level of cover);
- Amount of insurance (i.e. sum insured value of home buildings or contents);
- Amount of excess accepted by consumers;
- Listed events covered (i.e. fire, theft, storm, flood and earthquake, vandalism, broken glass, animal damage, water and oil leaks); and
- optional cover (i.e. accidental damage, coverage for electric motors e.g. refrigeration, identity theft, additional coverage for plants, spoiled food and prescription medicine, building materials, temporary accommodation for owners and pets, credit card theft, visitor belongings, cost of living expenses).

There is a significant question mark over whether an aggregator website would exert any downward pressure on insurers' margins. The net impact on premiums depends on costs as well as benefits. If a 'live-quote' aggregator site was introduced, those costs would include the expense of running the aggregator site, the cost of providing information to the aggregator, monitoring its use by the aggregator, and other costs such as the commissions extracted by aggregators along with the sale of advertising space. Costs (technology, compliance and business) for a 'live-quote' aggregator site are likely to be considerable. IAG will provide Treasury with an estimate on specific costs related to a 'live-quote' aggregator site. The FuelWatch experience points to potential causes of perverse affordability outcomes. One of the key problems with the scheme and the proposed national equivalent that ultimately failed to win the necessary support in Parliament was the disincentive created for price discounting by the price notification procedures.

Moreover, aggregators would increase the scope for cherry picking of lower risk customers and thereby reduce the capacity for insurers like IAG to cap premium increases for higher risk policy holders. In other words, the more effective the aggregator were to be in increasing competitive pressure, the greater the likelihood that affordability would be further reduced for the high-risk subset of the customer base that the mechanism is intended to assist.

Finally, the recent failure of OBS to provide insurance options accompanied by premium relief to NQ also more broadly demonstrates the limitations of an aggregator mechanism. OBS did not offer cover to most areas in NQ – conceivably if it had, premiums would have been significantly higher than those in lower risk regions.

INSURANCE AGGREGATORS (CONTINUED)

Limitations of the UK approach

Home insurance in the UK is priced differently to Australia. Unlike large Australian insurers with the capability to understand risks such as cyclones and to price the risks at an individual household level, UK insurers have not moved to the same granular level.

In Australia, significant improvements in data availability and interpretation capability are allowing insurers to assess an individual customer's personal circumstances to ensure their premium reflects the risk. This takes into consideration a property's exposure to events like cyclones and storms. Household pricing recognises customers as individuals, each with their own risk profile, instead of treating them as a postcode, demographic group or risk factor. This means pricing is increasingly more granular and dynamic. Insurance premiums therefore send a price signal to property holders regarding the level of risk they are exposed to.

Unlike the UK, where home and motor insurance products are standardised, the purchase of Australian general insurance requires due consideration by consumers. The scope of cover, product options and claims service capability vary greatly across the industry. The individualised, risk-based pricing model utilised by Australian insurers thus can't effectively translate to an aggregator website.

As seen in the UK, current aggregator models provide only simplistic and often an inaccurate overview of insurance policies. They reduce the purchasing decision to one based on price alone. In our view, this leads to a 'lowest common denominator' approach where consumers make purchasing decisions without due regard for differences in policy cover, product options and claims service capabilities, ultimately to their detriment.

In our view, the UK experience shows that when 'live-quote' aggregators enter a market they shift the consumer purchasing decision to one based on price alone, rapidly accelerating the process of commoditisation of general insurance, and removing the ability to tailor cover and pricing to individual consumer needs. This, in turn:

- Decreases service quality at both sales and claims consumer touch points;
- Devalues and removes differentiation in products meaning that consumers may miss out on coverage options that suit their personal needs; and
- Decreases the likelihood that consumers are adequately informed about their insurance policy.

A strata insurance comparison website

It is not possible to price strata insurance on an aggregator site. Strata insurance is an intermediated product by nature; it isn't available to the average consumer via the internet or over the phone. This is why most strata insurance in NQ is sold by insurance brokers, who assist consumers with their purchasing decision and negotiate with insurers to provide risk information. This in turn leads to customers receiving optimum cover at the best price. For example, brokers and agents provide advice and a range of quotes to bodies corporate for them to consider, after examining a large range of factors unique to each building.

The implementation of an aggregator function for strata insurance would simply not be able to provide a usable service to consumers, would displace brokers, and also remove from bodies corporate the advantage of having an insurance expert provide advice on relevant products as well as leveraging policies across multiple bodies corporate and associated discounts.

INSURANCE AGGREGATORS (CONTINUED)

As is the case with home insurance, getting all insurers to agree to a single question set would be extremely complex - if not impossible. Process changes required would include data mainframes, employee facing front end systems, internet sales processes, employee training, underwriting technology and process changes and rating engine changes. And the complications go beyond technology. In the case of strata insurance, the insured who completes the questions is usually a strata manager, who does not always have an intimate knowledge of the property's risk attributes. And a strata manager cannot rely on a building representative to complete the questions accurately. Furthermore, there are numerous owners in a strata complex including many absentee investors.

Housing an aggregator site

IAG doesn't believe 'live-quote' comparison sites provide customers with all the necessary information they require need to make an informed decision when purchasing insurance. Should the Federal Government wish to proceed with this approach, we believe ASIC, which already has insurance information on its MoneySmart website, should potentially be expanded to accommodate the site.

IAG would also like to highlight the significant problems and risks associated with private operators of insurance comparison websites, especially in relation to transparency. Moreover, 'livequote' insurance aggregators generate income and profits in a variety of ways, such as through the sale of advertising space and the collection of click-through commissions when insurance policies are purchased. In turn, service standards erode; policy options diminish, and product innovation stalls, leading to insurance coverage that is compromised to the detriment of the consumer.

The 2011 UK Financial Services Authority (FSA) Price Comparison Review found that some websites led customers to inappropriate insurance deals and that aggregators overly focus on maximising revenue without sufficiently regarding regulatory compliances. The UK Financial Conduct Authority (FCA) is undertaking a Price Comparison Website Review. The review will focus on motor, home and travel insurance and will look at 14 price comparison websites (representing 90% of the market), to ensure that their rapid growth in popularity has not come at the expense of transparency and fairness. The FCA claims it wants to be sure that consumers are not being misled into believing they are buying the best product when they may not be. More particularly, the FCA is exploring whether consumers may not fully understand the services provided by price comparison websites and may be misled into purchasing insurance or add-on products that do not meet their needs.

In May 2013, ASIC's concerns about potentially misleading content on the insurance comparison website of JustEzi led to the removal of online material. Indeed this website is still relatively inactive today and does not have any updated insurance information on it. JustEzi was ranking insurers by price after consumers entered certain details. ASIC was concerned that these estimates may be misleading as they were significantly different to quotes offered by the relevant insurers. Further, on many occasions the price rankings placed on the relevant insurers were inaccurate. ASIC found the estimates may be misleading because a consumer may consider: an Ezi-Esti mate to be the same as a quote obtained from an insurer's website; or the ranking (on price) if the quotes were obtained from the various insurers' websites.

A way forward

Australian governments recognise that efficient and effective regulation is necessary and desirable to facilitate the smooth functioning of the economy and to ensure that social, economic and environmental aims are achieved. Governments should not act to address

INSURANCE AGGREGATORS (CONTINUED)

“problems” through regulation unless a case for action has been clearly established. Moreover, any regulatory or legislative response should be proportional to the issue or “problem” being addressed.








While IAG believes a price comparison site will not bring down the prices in NQ, the Victorian Fire Services Levy (FSL) monitor type comparison site (static, ‘point in time’ quotes) with additional consumer information provides an example of a workable model, which is least costly and least disruptive (of the comparison website options proposed) for the functioning and sustainability of the NQ insurance market.

In addition to the aforementioned, we believe customers would benefit from a claims comparison feature. This would incorporate FOS data and rank insurers based on the following criteria: chance of dispute coming to FOS (per 100,000 claims as an example); average length in resolution — in months; and claim contact hours. The LMI Claims comparison site provides a useful illustration. Finally, IAG also believes a site which covers (and is restricted to) this information would appropriately cover off on the risks identified with a ‘live-quote’ aggregator site.

Property location [\$300,000 sum insured]	AAMI	Allianz	APIA	Comm Insure	QBE	RACV	Bankwest	Coles	Range	Lows as percentage of High
Bendigo	\$343	\$415	\$424	\$453	\$788	\$466	\$594	\$483	\$445	44%
Glen Iris	\$399	\$449	\$482	\$443	\$590	\$681	\$656	\$565	\$282	59%
Echuca	\$322	\$408	\$418	\$422	\$761	N/A	\$581	\$1,209	\$887	27%
Surrey Hills	\$379	\$437	\$450	\$453	\$590	\$510	\$603	\$561	\$224	63%

Source: Victorian Fire Services Levy Monitor: <http://www.firelevymonitor.vic.gov.au/>

INSURANCE AGGREGATORS (CONTINUED)

Company	Product	Star Rating	Online Discount	Pay Monthly at No Extra Cost	Nil Excess Available	Flood Inclusions			Home Inclusions		
						Riverine Flood Cover	Flash Flooding	Storm Surge	Accidental Damage	Fusion Cover	Under Insured Protect
	ANZ Home Insurance	★★★★★	0%	✓	✗	✓	✓	✗	✓	✓	✓
	Secure Home Extra	★★★★★	0%	✓	✗	✓	✓	✗	✗	✓	✗
	Accidental Damage/ Secure Home Elite	★★★★★	0%	✓	✓	✓	✓	✗	✓	✓	✗
	Defined Events/ Secure Home Extra	★★★★★	0%	✓	✓	✓	✓	✗	✗	✓	✗
	Accidental Damage	★★★★★	0%	✓	✓	✓	✓	✗	✓	✓	✗
	Defined Events	★★★★★	0%	✓	✓	✓	✓	✗	✗	✓	✗
	Home & Contents	★★★★★	0%	✓	✗	✓	✓	✗	○	✓	✓

Source: Canstar: <http://www.canstar.com.au/home-and-contents-insurance/>

Overall Weighting	Private Motor	Home & Contents	Home Building	Small Business / Farm Insurance	Travel Insurance
Financial Ombudsmen Service Data^[1]					
Ranked - Chances of Dispute Coming to FOS (Disputes per 100,000) ^[2]	20.0%	25.0%	25.0%	0.0%	25.0%
Ranked Average Length in Resolution (Months) ^[3]	5.0%	5.0%	5.0%	5.0%	5.0%
Ranked Resolution by Agreement & Other ^[4]	12.5%	12.5%	12.5%	20.0%	12.5%
Ranked Resolution In Favour of Applicant ^[5]	12.5%	15.0%	15.0%	30.0%	15.0%
Sub Total	50.0%	57.5%	57.5%	55.0%	57.5%
Claim Contact Hours^[6]	10.0%	32.5%	32.5%	30.0%	32.5%
Choice of Repairer ^[7]	15.0%	0.0%	0.0%	0.0%	0.0%
Repairer Guarantee ^[7]	15.0%	0.0%	0.0%	0.0%	0.0%
Survey ^{[8][9]}	10.0%	10.0%	10.0%	15.0%	10.0%
Sub Total	50.0%	42.5%	42.5%	45.0%	42.5%
Total Weighting	100.0%	100.0%	100.0%	100.0%	100.0%

Source: LMI Claims Comparison: <http://www.claimscomparison.com/>

The type of comparison site will determine whether any confidentiality or privacy implications arise. For example, a static product features/sample pricing site would not pose any privacy implications as consumers would not be inputting personal information. However, a 'live-quote' aggregator site would require consumers to provide their personal information to generate quotes, posing potential privacy concerns. The administrator of such a site (whether run by a government agency or a private operator) would need to ensure the Australian Privacy Principles are complied with in the collection, use, disclosure and storage of the personal information.

Moreover, in the case of a 'live-quote' aggregator site, there is a risk for misleading or inaccurate/obsolete pricing information being displayed. Presumably, responsibility and ultimately

INSURANCE AGGREGATORS (CONTINUED)

liability for any damage incurred rests with the site administrator. Insurers who participate in the comparison website would expect to be indemnified for any potential action taken against them for the accuracy of information provided.

Again, IAG submits that any regulatory or legislative response should be proportional to the issue or “problem” being addressed and only the option that generates the greatest net benefit for the community, taking into account all the impacts, should be adopted.

UNAUTHORISED FOREIGN INSURERS AND NORTH QUEENSLAND

If unauthorised foreign insurers are permitted to operate with relaxed restrictions, consumers remain inappropriately exposed. The main rationale for prudential regulation of general insurance is consumer protection. It also has a role in ensuring that a level playing field is maintained with respect to competition when implementing prudential regulation. Some niche and other sensitive lines of insurance are precisely the sectors of the market that require a strong regulatory presence by virtue of the high risk nature of the activities and property being insured.

Within the general insurance sector, IAG considers that substantial information 'asymmetry' exists, in that policyholders may not be equipped with sufficient information on which to base a decision to insure. The consequences of this are adverse for policyholders if it results in insurance claims not being met. It is unreasonable to expect retail consumers to conduct a detailed review of the financial security of their insurance contract or its provider. They should be entitled to assume a base level of security from all providers of retail insurance operating in the local market.

IAG considers that an insurance market, which has companies operating in a regulatory vacuum for the sake of ensuring that cover is available to those who seek it (no matter what the quality), is not an optimal public policy result. IAG believes that it suggests a misplaced concern for an outcome rather than a viable ongoing solution to the original problem. IAG believes all providers of insurance products should be required to meet the APRA prudential and reporting standards. IAG submits that this helps develop a level prudential playing field. To ensure best practice, the performance of different entities providing those products must be measured on the same basis. IAG believes both APRA and ASIC would not be favourably disposed towards arrangements that granted certain privileges to some insurers.

Finally, if unauthorised foreign insurers (UFIs) are not subject to the same prudential regulations as Australian licensed insurers, they would gain an unfair competitive advantage over locally operating insurers. Moreover, there is potential for UFIs to not exhibit the same loyalty to the Australian market, creating big question marks for policyholders over whether their insurer will be operating here when the time comes to pay their claims. Policyholders would not have the protection of the Financial Claims Scheme to fund their claims in the event that a UFI's Australian operation fails. Additionally, there is a risk that consumers/bodies corporate may be unable to differentiate between a UFI and a local licensed insurer and unknowingly expose themselves to all the risks that come with an unregulated player.

ENHANCING RESILIENCE IN NORTH QUEENSLAND

There has been an upward trend in natural disaster costs in Australia, particularly since 2000. At present, the total economic costs of natural disasters in Australia are estimated to average around \$6.3 billion per year. In real terms, this total is forecast to grow by 3.5% annually. This is primarily due to the likely impact of further population growth, concentrated infrastructure density, and the effect of internal migration to particularly vulnerable regions. With this growth rate, the annual total economic cost of natural disasters in Australia is expected to double by 2030 and reach \$23 billion in real terms by 2050⁶.

Cost-effective investment

The expected future costs of natural disasters highlight the need for governments to invest further in resilience measures. As the government does not currently account for future disaster costs in the forward estimates, it is difficult to recognise the true cost advantages of building resilience. *Building our Nation's Resilience to Natural Disasters* shows that the budgetary impact of responding to and recovering from natural disasters could potentially be significantly reduced through carefully considered and directed investment in pre-disaster resilience.

A simple cost-benefit analysis demonstrates how government funds would be saved over the longer term by bringing forward expenditure on natural disaster recovery and placing a greater level of investment in pre-disaster resilience measures. Assume, for example, that carefully-targeted programs of resilience expenditure in the order of \$250 million per annum achieved an overall Benefit-Cost Ratio (BCR) of around 1.25. This implies that this program of expenditure would incur costs in the order of \$5.3 billion over the period to 2050 (present value terms) but would generate budget savings in the order of \$12.2 billion for all levels of government (or \$9.8 billion when looking at the Australian Government budget only). If successfully implemented, this intervention could see Australian and state government expenditure on natural disaster response, fall by more than 50% by 2050.

Importantly, there are a number of factors contributing to the increased economic and community impact of natural perils. We are seeing marked increases in population density, especially in areas that are prone to natural disasters (particularly around coastal areas), leading to more damage and a rise in the quantum of damage. The increasing value of building and contents and sub-par building standards, also contribute to a rise in the cost of natural disasters.

Any policy response must go beyond insurance and also focus on prevention. More insurance products will not prevent natural disasters from occurring in future. To truly build the resilience of our communities and reduce their exposure to significant natural peril risk, a broader response is required. Some proposals include:

- Higher quality planning standards for local government, to ensure no further development is allowed in areas of unacceptable risk. Property owners in most extreme risk areas should be provided with incentives to move to safer areas, as has happened in Grantham;
- Building standards need to be updated to reflect the need to protect property, as well as lives, against the risk of natural hazards; and
- Greater transparency around the mapping and information to help householders and businesses understand the flood risk in their location. This information has significant economic

⁶ Australian Business Roundtable for Disaster Resilience and Safer Communities commissioned Deloitte Access Economics Report *"Building Our Nations Resilience to Natural Disasters"* 20 June p 19

ENHANCING RESILIENCE IN NORTH QUEENSLAND (CONTINUED)

value, as it reduces risk, will benefit planning authorities, developers, banks and financiers and allows insurers to underwrite the risks with maximum certainty.

IAG believes the most effective way to tackle insurance affordability, accessibility and participation is through a nationally-coordinated and well-resourced disaster resilience program that reduces the impact of extreme weather events. IAG supports a co-ordinated and collaborative national approach, involving all three levels of government and insurers, to managing the impact of natural disasters on the community including government, the insurance industry and the broader community. Key focal points include:

- Risk mapping, planning regulations, building standards, and mitigation works that reduce risk;
- A government programme to prioritise mitigation spending to those areas that return the greatest benefit cost ratio;
- Greater community awareness of the risks and a better understanding of the role individuals, businesses and communities play in reducing risk;
- Government assistance to local governments with repairs to infrastructure after a disaster, to bring the infrastructure back to the same standard as before. Our discussion with local governments has highlighted the need to repair to a more resilient standard, which would save taxpayers funds in the long term. The Federal Government has a 'betterment' provision but access is extremely difficult and local governments are reluctant; and
- We believe the current Productivity Commission Inquiry into Natural Disaster Funding is an important opportunity to review the funding and policy settings on disaster resilience and IAG will be actively contributing to the Inquiry.

Enhancing strata resilience

IAG believes there are options for the Federal Government to assist further with strata building resilience. CGU/SUU has rolled out a strata building resilience project to enhance resilience and address insurance affordability in NQ. The project focuses on improving building resilience to severe weather so that customers can receive sustainable premium reductions. The assessments cover risks such as building construction type and method, exposure to direct wind-driven rain, as well as other hazards and possible defects. Following completion of each assessment, CGU/SUU is revisiting its pricing and reducing premiums where possible. Importantly, this project is being funded in an effort to provide more affordable and sustainable strata insurance premiums.

Recommendations from the assessments are being provided to strata property owners and managers on repairs that can be made to improve the property's resilience and risk rating, enabling the properties to potentially be re-rated so that customers receive sustainable premium discounts. Should the body corporate wish to have the remedial works carried out, SUU could facilitate a detailed quote either through the building manager's preferred trades people or local businesses.

There is potential for the project to be developed further. CGU is exploring options to further assist policy holders, so that the repairs can be undertaken at the earliest opportunity and our customers can experience the full benefits of this work. To offset possible funding challenges, SUU has commenced discussions with a major financial institution to facilitate access to finance for bodies corporate wishing to make the recommended repairs. CGU is also in discussions with the ICA about how the project can complement the James Cook University (JCU) initiative on strata building assessment methodologies.

ENHANCING RESILIENCE IN NORTH QUEENSLAND (CONTINUED)

CGU hopes the project will further embed sustainable pricing focused on risk as well as having important benefits for human safety from flying debris, and improved property values. If the bodies corporate carry out the works required to increase resilience this would also result in a lowering of premiums together with an improvement in personal and asset safety, improving the capital value of the assets.

Early results from the building assessments have been encouraging. SUU has been able to provide up-front premium relief in the range of 12.5 to 15 percent for several of the properties that have been assessed so far. These premium discounts could not be offered earlier because the insured wasn't in a position to identify the building risks that have been identified in the assessments. SUU is currently circulating to bodies corporate recommendations or requirements on building works that can be undertaken so that further sustainable premium reductions can be achieved.

CGU has offered to share the findings of the building assessments with government, councils and other interested stakeholders, to improve knowledge and awareness of building codes, materials, and other mitigation, which all impact on insurance premiums. For example, the findings of the building assessment reports could be useful for local councils with a view to making changes to building codes so that they include weather resilience. This would help address affordability issues over the longer term as new buildings should be built to withstand extreme weather. The longer term impact of all of these initiatives will not only help the affordability issue but will also likely increase the value of assets in the region. It is also fair to say that a more sustainable insurance environment would lead to an increase in competition within the area.

IAG believes this work is best undertaken by the private sector. For example, once a body corporate undertakes a survey, what do they do — there are only two strata insurers in the market, and there is no-one to co-ordinate remedial works if the body corporate is not already insured with a strata insurer committed to working with its customers. For those bodies corporate currently struggling to obtain cover, surveys could highlight more issues than the body corporate can afford to address. Moreover, short of the creation of costly bureaucratic arrangements, a government-run scheme couldn't assist with providing concessional finance to bodies corporate.

In terms of enhancing strata resilience, IAG believes the government should consider using its funds to:

- Engage JCU, in consultation with a risk modelling firm, to come up with a single, reliable, up-to-date catastrophe (CAT) model that can be adopted by the industry. This could also be used for other building types, benefitting both home owners and business owners.
- Fund a respected and well-credentialed CAT risk modelling company to conduct a risk assessment of NQ, broken down by industry segments. This would inform the governments and the community about realistic costs from a catastrophe and remove the speculation about the cost of potential catastrophes. It could also assist governments at all levels who self-insure to better understand their risks, so they also get a direct benefit.
- Fund JCU to create a best practice guide on how to best construct a building, covering materials and maintenance. Current building codes address the resilience of the structure, not water ingress through wind-driven rain.

ENHANCING RESILIENCE IN NORTH QUEENSLAND (CONTINUED)

Affordable basic home insurance products

Damage threshold

NRMA Insurance is investigating options for developing a new home insurance product that would provide cover for major perils above a certain threshold i.e. \$50,000 - \$100,000 (damage threshold policy). A viable option for reducing premiums in high risk areas is to provide for a damage limit such that if a threshold is not reached then the insured pays for the damage, but if the threshold is reached or exceeded then the insurers pays for the entire damage amount. High level estimates have been developed based on a new product which indicates savings of up to 66% for a \$75k threshold. This type of policy would assure full cover where the loss exceeds the damage amount. An alternative feature would enable a customer to select a much higher excess (up to \$20k), involving a degree of self-insurance.

The federal and state governments could support the viability of these products as a means of providing affordable flood insurance by covering some of the cost of the excess or the uninsured portion of the claim in the event of a flood. This could be established through the existing Natural Disaster Relief and Recovery Arrangements (NDRRA) funding mechanisms by adjusting the eligibility criteria for grants to repair and rebuild homes.

Higher excesses

Higher excesses can help lower prices as increasing the amount of excess paid upon making a claim could reduce the cost of the premium. IAG currently offers flexibility in payment of premiums by allowing customers to elect to pay a higher excess of up to \$5000 and reduce their premiums by up to 20%. By choosing a higher basic excess on the policy from a wide range of excess options, customers are able to decrease their premium. One option could be to increase the level of excess substantially (i.e. up to \$50,000) to further reduce the premium. However, we note that this effectively means the insured must also self-insure a portion of the risk and relocate the stress point to when a claim is made — which is often when the insured is already experiencing hardship — rather than when the premium is paid.

Micro-insurance

Micro-insurance may offer a solution to segments of the community that are unable to access insurance due to socioeconomic factors. The level of cover of conventional products is often inappropriate for low income earners as they are far higher than required. Payment issues including timing and method pose another barrier to this group accessing insurance⁷.

Micro-insurance products provide risk protection for the low income population against specific perils by offering a variety of tailor made products. Products and delivery models need to fit the requirements of low-income populations rather than offer miniaturised versions of conventional products. Hence in order to offer this product, the insurance industry would require co-operation from both community groups and regulatory bodies.

The International Association of Insurance Supervisors (IAIS) advises that primary legislation should allow flexibility to respond to new innovations yet offer increased protection to this customer

⁷ Collins D 2011 *Reducing the Risks, Improving access to home contents and vehicle insurance for low income Australians*, Brotherhood of St Laurence

ENHANCING RESILIENCE IN NORTH QUEENSLAND (CONTINUED)

segment. Traditional regulatory frameworks are designed for products and services for higher income customers and the primary law should be as broad and permissible as possible to enable innovation of micro-insurance products. Conversely, consumer protection needs are higher when extending access to insurance to a customer segment with low financial literacy and limited experience with insurance⁸.

A micro-insurance product would need to be supported by accessible information and advice. Successful uptake of micro-insurance would involve developing financial literacy and capability in the low income sector. Collaboration with the community sector would also be necessary to offer alternative distribution channels and help people access clear information about suitable products to meet their needs. IAG is currently examining this option with community groups.

⁸ Application Paper on Regulating and Supporting Inclusive Insurance Markets, International Association of Insurance Supervisors (IAIS)2012