



2009 Victorian Bushfires  
Royal Commission

## Submissions cover sheet

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Submissions 2009 Victorian Bushfires Royal Commission  
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Title:	First Name:	Surname:
Organisation represented by your submission (if applicable): Insurance Council of Australia Limited		
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Main topics addressed by your submission (please tick):		
<input type="checkbox"/> Causes and circumstances of the bushfires	<input type="checkbox"/> Essential services, including water and power	
<input type="checkbox"/> Policy, preparation and planning of governments, emergency services	<input type="checkbox"/> Buildings	
<input type="checkbox"/> Preparation and planning by communities and households	<input checked="" type="checkbox"/> Insurance	
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Please list any towns or communities that are discussed in detail in your submission:		
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• 1 x submission and annexures thereto		

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The Insurance Council of Australia

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Signature:

[Redacted] of Allens Arthur Robinson for and on behalf of  
the Insurance Council of Australia.

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Date 11 January 2010.

The Insurance Council of Australia Ltd<sup>1</sup> is pleased to provide this response to the Royal Commission's discussion paper entitled 'The Fire Services Levy and Insurance' dated November 2009. This paper addresses each of the questions posed in the discussion paper.

## INTRODUCTION

As noted in the discussion paper, the 2009 Victorian bushfires have resulted in widespread community concern about the current insurance-based system of fire services funding in Victoria. The Insurance Council shares this concern and contends that the current system, which involves insurance companies recovering the cost of their mandated statutory contributions to metropolitan and rural fire services through the imposition of a Fire Services Levy (**FSL**) on building and contents insurance policyholders, increases non-insurance and under-insurance levels in the community. This, in turn, results in:

- an inequitable situation in which those who take out adequate building and contents insurance, effectively, fund fire services for other members of the community; and
- non-insured and under-insured people relying more heavily upon government and public assistance in the event of disaster like the 2009 Victorian bushfires.

Further, there is broad acceptance that the taxes on insurance products are amongst the most inefficient means of revenue raising options available to government.

The Insurance Council maintains that the Royal Commission ought to determine that the present FSL scheme should be abandoned by the Victorian State Government in favour of a revenue scheme that applies to all property owners and which is more reflective of fire and bushfire risk than the current scheme. Among other things, this will result in a more equitable sharing of the cost of fire services and increased levels of building and contents, that does not serve to discourage the adoption of an appropriate level of insurance cover throughout the Victorian community. Ultimately, the removal of the FSL system will enable the Victorian community to become more resilient to bushfires and other catastrophes so that many of the concerns and challenges experienced in the wake of the 2009 bushfires may not arise in the future.

## FUNDING VICTORIA'S FIRE SERVICES

The general insurance industry is subject to two tiers of taxation in Victoria. They are:

- Statutory contributions to the fire services under the Victorian Metropolitan Fire Brigades Act 1958 and the Country Fire Authority Act 1958
- Stamp duties on general insurance premium but excluding certain classes of insurance

Victoria has two public fire services, the Victorian Metropolitan Fire Brigade (**MFB**) and the Victorian Country Fire Authority (**CFA**). The administration and funding arrangements of the MFB and the CFA are governed by the Metropolitan Fire Brigades Act 1958 (**MFB Act**) and Country Fire Authority Act 1958 (**CFA Act**) respectively.<sup>2</sup>

Under Section 37 of the MFB Act insurance companies insuring properties against fire in the MFB district are required to meet 75% of the expenditure of the MFB. The remaining proportion of MFB funding is met equally from the consolidated fund and the local authorities in the MFB district.

<sup>1</sup> The Insurance Council of Australia is the representative body of general insurance companies in Australia licensed under the *Insurance Act 1973* (Cth). Its 52 members represent more than 90 percent of total premium income written by private sector general insurers. Insurance Council members, both insurers and reinsurers, are a significant part of the financial services system. June 2009 Australian Prudential Regulation Authority statistics show that the private sector insurance industry generates gross premium revenue of \$32.0 billion per annum and has assets of \$95.2 billion. The industry employs approx 60,000 people and on average pays out about \$97.5 million in claims each working day. Insurance Council members provide insurance products ranging from those usually purchased by individuals (such as home and contents insurance, travel insurance, motor vehicle insurance) to those purchased by small businesses and larger organisations (such as product and public liability insurance, professional indemnity insurance, commercial property, and directors and officers insurance). It contributes to public policy debates that are of relevance and importance to the general insurance industry and to its key stakeholders – consumers and Governments. In addition, the Insurance Council under the industry's Catastrophe Coordination Arrangements plays a key role at times of catastrophes with its members by liaising and problem solving for consumers and Governments.

<sup>2</sup> Insurer contributions to the Victorian fire services are also regulated by the Metropolitan Fire Brigades (Contributions) Regulation 2009 and the Country Fire Authority (Contributions) Regulation 2009.

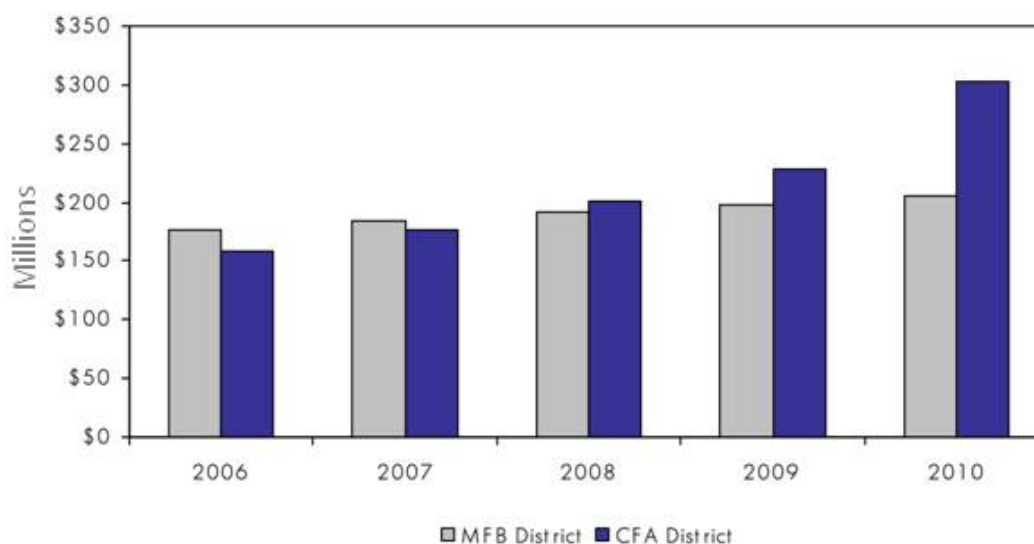
Similarly, under Section 76 of the CFA Act, insurance companies insuring properties against fire in the CFA district are required to meet 77.5% of the CFA expenditure with the remaining proportion being met from the consolidated fund.

The statutory amount payable by each insurer is determined by three factors – the size of the budget to be funded; the aggregate market share of the insurer and the individual insurers mix of classes of insurance. The latter is significant as not all insurance policies are weighted equivalently for the purpose of contribution levies. For instance, contribution charges are greater for commercial classes of insurance than they are for residential or domestic policies.<sup>3</sup>

Over the last decade, the Victorian fire services have seen considerable enhancement to their funding positions relative to population growth. For example, between June 2001 and June 2008, the budget in the MFB catchment area has increased on a per capita basis from \$51 to \$83 – an increase of 63%. Over the same period, the Victorian CFA has seen its budget in its catchment area increase from \$63 per head of population to \$116, an increase of 84%.<sup>4</sup>

Increases to fire services budgets translate into greater contributions under the statutory fire funding formula. For example, since 2005/06, insurer contributions to the Victorian fire brigades have increased by over 50% to \$509 million.

**Chart 1: Insurance Contributions to Victorian Fire Services Budget**



Source: Insurance Council & Victorian Fire Authorities

Insurers recover their insurance contributions to the fire services by levying their insurance policy holders. The extent to which insurers recover a “fire levy” from their insured’s is purely a commercial decision on the part of individual insurers. There exists no legal requirement in either the MFB or CFA Acts for insurance companies to explicitly identify a fire services “levy” or indeed, ensure any identified “fire service “levy” equates with their statutory contribution. Failure to recover such statutory fire contributions from policyholders would otherwise require such funding to be internal to the insurance companies, thereby affecting the costs associated with the affected classes and potentially resulting in insurers declining to offer cover.<sup>5</sup>

The actual process of determining the appropriate recovery amount for fire contributions is complex and extremely difficult for insurers. Given that contributions are sought in advance (leaving insurers with the task of forecasting the market going forward) and that any insurance recovery takes place on the actual insurance premium base, fluctuations in both the insurer’s market share (i.e. mixes of business) and the

<sup>3</sup> For a summary of the statutory contribution steps please refer to Vic DTF (July 2003) “A Review of Victorian Fire Services: Funding Arrangements” at page 21.

<sup>4</sup> Source: MFB and CFA, Australian Bureau of Statistics Census & Population statistics

<sup>5</sup> This process underlines the claim that the fire services levy is not a “tax” imposed by Government. See Victorian DTF “A Review of Victorian Fire Services Funding Arrangements: July 2003” at page v

actual premium levels attained (i.e. hardening or softening markets) results in insurance companies bearing all collection risk for the fire services. The likelihood of under or over collection is therefore an inevitable and inappropriate feature and failure of the current system.

Only NSW, Victoria (and to a lesser extent Tasmania) retain statutory contributions funding systems for the funding of the fire services. In recent times, most other State administrations have transitioned to systems where fire and emergency services levies are collected through charges on property value rather than on insurance premiums.<sup>6</sup> An outline of the fire and emergency services systems across Australia is provided at Annexure A.

Internationally, there are a number of models/approaches used to fund the fire services although by far, property based systems and direct grants to the fire and emergency services are the most common form of funding. For example, the London Fire Brigade (an arm of the London Fire & Emergency Planning Authority (**LFEPA**)) secures the bulk of its funding from central government funding and the remainder from London boroughs primarily through taxes on property.<sup>7</sup>

Similarly, in the United States although local governments use a variety of methods to enhance the funding of the professional fire services, the most common taxes supporting fire and emergency services remain property taxes usually levied at a set rate per dollar of assessed value.<sup>8</sup>

In contrast, the New Zealand Fire Service is funded through the imposition of a fire service levy on insurance policies to the value of 7.6 cents per \$100 of insured value for residential, commercial and personal property (with a cap of \$100,000 for residential property insurance, \$20,000 for personal property and no cap for commercial). Motor vehicles less than 3.5 tonnes are levied a flat rate of \$6.08 per vehicle.

An outline of a range of international approaches to funding fire and emergency services is set out at Annexure B

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

The discussion paper refers to a number of arguments in favour of Victoria's insurance-based model. They include:

- "The FSL is notionally risk-rated because it is based on insurance premiums that are assessed to reflect fire risk."

As will be discussed later in this submission, insurance premiums in Victoria incorporate little, or in many cases no risk rating for fire and bushfire. Insurance premiums are strongly based on the value of the asset and risks other than bushfire.

- "It provides a stable revenue base for fire services with low administration costs."

The Insurance based FSL model allows a transfer of costs to Victorian residents who choose to insure. Overheads for administration of the system are managed by insurers. Therefore this statement is only true with regard to the government's administration costs.

- "It provides asset owners with some degree of incentive to manage fire risk through the use of fire prevention systems and the development of on-site fire fighting capacities. These activities may reduce the insurance premium, and thus reduce the amount of FSL payable."

As will be explored later in this submission, bushfire risk is not explicitly incorporated as a factor in the many insurance policies in Victoria. There are no industry wide examples where the risk mitigation activities of a policyholder, in regard to bushfire risk, currently help reduce the premium payable due to the low or non-existent weight given to bushfire risk.

<sup>6</sup> For example, in June 2002 the Western Australia government announced reforms to emergency services funding stating "for too long there has been an unfair and inequitable situation with as many as one in three homes either not insured or under-insured, but still receiving emergency protection" See Western Australia Government Media Office, Ministerial Statements (12 June 2002) statement by WA Emergency Services Minister "New funding system to assist the State's volunteer emergency services"

<sup>7</sup> See London Fire Brigade "Statement of Accounts, 2007/08" at <http://www.london-fire.gov.uk/CorporatePublications.asp> and Victorian Department of Treasury & Finance (July 2003) "A Review of Victorian Fire Services: Funding Arrangements" at pages 104 - 105

<sup>8</sup> See US Federal Emergency Management Agency; US Fire Administration "Funding Alternatives for Fire & Emergency Services" available at <http://www.usfa.dhs.gov/downloads/pdf/publications/fa-141.pdf>

The principal disadvantages of an insurance based FSL model are that:

**FSL contributes to non-insurance and underinsurance and, thereby, discourages community resilience** – As noted above, FSL increases the cost of building and contents insurance substantially. This discourages people from taking out this insurance at all or to an adequate level and increases their reliance upon government and public assistance in the event of disaster like the 2009 bushfires. Research<sup>9</sup> demonstrates that the removal of fire services levies from insurance leads to a greater number of people taking out insurance with higher sums insured alleviating under-insurance.

**FSL is inequitable** – While the entire Victorian community benefits from fire services, a substantial section of the community which benefits from the provision of fire services does not contribute to the funding of those services. This includes property owners who do not take out any or any adequate building and contents insurance cover, motor vehicle owners, and other property owners (such as owners of vacant land). Operational call-out data for the Victorian fire services also demonstrates that the actual fire suppression activities of the fire services is not closely correlated with the supposed beneficiaries and funders of the services. Data on the call-out activities of the brigades, showing who benefited from operational activities, is maintained by the fire services and would be instructive to the Commission.

**FSL is inefficient** – All independent taxation reviews have to date found the taxes on insurance products are amongst the most inefficient means of revenue raising options available to government.<sup>10</sup>

The disadvantages of taxing insurance products in order to fund fire services have already been explored and agreed by a number of independent reviews, which have universally called for their reform, these are:

- 1) The 2001 Victorian Review of State Business Taxes (*The Harvey Review*)
- 2) The 2007 NSW Independent Pricing & Regulatory Tribunal Review of State Taxation
- 3) The 2003 HIH Royal Commission

A comprehensive summary of these reviews and the broader impacts of FSL and other insurance taxes are attached in the Insurance Council's *Submission to the Victorian Parliamentary Economic Development & Infrastructure Committee Inquiry into State Taxation & Debt*.

Despite the widespread benefits that accrue from the presence and availability of private insurance, insurance consumers remain unreasonably burdened by inefficient taxation imposts. In Victoria, general insurance purchase is subjected to three levels of taxation – imposts arising from the statutory contributions system for funding the fire services, the Goods and Services Tax and Stamp Duties on general insurance. Taxes on insurance represent one of the most inefficient of all Victorian State taxes, meaning that not only do insurance taxes detract from the prudent take up of insurance; they result in large deadweight costs to the Victorian economy and represent a drag to economic well being.

One of the major arguments used to support the current insurance levy approach is the notion that the primary beneficiary of an efficient and capable fire fighting service is the insurance industry. The Insurance Council firmly rejects this view:

- As the call out data from the Victorian fire services indicates, the fire services are used in motor vehicle rescue and accidents as well as for presentations at hazardous conditions and good intent events.<sup>11</sup> As indicated earlier in this submission, the fire services hold more precise data on this issue which may demonstrate that actual fire service activities do not underline the current beneficiary pays argument to the extent relied upon by government. This data is not able to be released by the Insurance Council but may be available to the Royal Commission if requested from the fire services.
- The fire services are best described as public goods to the extent that the use of the resource by one individual does not exclude its use by another. Unlike other publicly provided goods, such as roads, rail etc, public goods (which would include the police, the courts, defence etc) are not generally funded by user pay systems.
- The Insurance industry benefits no more from these public goods than the community in general so the notion of the industry funding them is inequitable.

<sup>9</sup> Tooth & Barker, 'The Non-insured: Who, Why and Trends' prepared for the Insurance Council of Australia, May 2007, Tooth, 'An Analysis of the Demand for House and Contents Insurance in Australia: A report for the Insurance Council of Australia' and SIGMA Plus Consulting, 'Emergency Services Levy, Insurance Compliance Review Final Report', 2004.

<sup>10</sup> Insurance Council submission to the Victorian Parliamentary Economic Development & Infrastructure Committee Inquiry into State Government Taxation & Debt, p 21 and 22.

<sup>11</sup> MFB and CFA Annual Reports

There are more equitable solutions to the funding of fires services, that acknowledge the cost of the service should be across the entire community not just those segments that purchase general insurance. These alternatives, predominately a charge on land holding, have been adopted in other States and have not detracted from the adequate funding of the emergency services. Some systems also incorporate a risk component for the charge, based upon land-zoning and property use, necessitating that those at higher risk pay a proportionally higher charge.

Therefore, as noted above, the Insurance Council maintains that the present FSL scheme should be abandoned by the Victorian State Government in favour of a revenue scheme that applies to all property owners and which is more appropriately reflective of fire and bushfire risk than the current scheme. This will result in a more equitable sharing of the cost of the fire services and increased levels of building and contents insurance cover throughout Victoria. Ultimately, the removal of the FSL system will enable the Victorian community to become more resilient to bushfires and other catastrophes so that many of the concerns and challenges experienced in the wake of the 2009 bushfires may not arise in the future.

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

The Insurance Council is opposed to this proposal as it will involve:

- considerable administrative complexities in identifying those people who are not insured or are under-insured;
- intrusive enquiries into the level of insurance maintained by property owners and occupiers and likely expensive issues about the valuation of properties and contents to identify any non-insurance or under-insurance.

Furthermore, the revenue generated by such a system after meeting costs of complex inquiries and calculations required may not give rise to any significant net benefit.

There are also a myriad of probable privacy, legal, data, transaction and equity complexities that flow from the potential operation of such a system and the annual transaction costs would in all probability far exceed the one-off costs associated with transitioning to a more equitable system that captures all users of the fire services as a baseline. Further, such a proposal would be akin to requiring all property holders in Victoria to hold a given level of cover, with this cover to be determined through regulation or statute. Consistent with such compulsion (and as is typical of such compulsory schemes) such a regime would require an overarching regulatory and pricing supervisory framework.

Therefore, the Insurance Council does not support this approach and submits that the Royal Commission ought to recommend against its adoption.

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

The primary advantage of a property based system is that all potential users of the service would be contributors to its funding, removing existing equity conflicts with the FSL system.

For the reasons outlined above, removal of the FSL system will also encourage people to take out adequate building and contents insurance cover and, thereby, increase community resilience against the effects of disasters like the 2009 Victorian bushfires and other significant property risks.

There are no factors in Victoria that prevent or make impracticable, a property based system in Victoria, as is used in other states. Alignment with the revenue models used in other fiscally performing states would also generate opportunities for exchange of policy initiatives.

Indeed, there are factors in Victoria that would make the application of such a system highly practical and potentially even more efficient than in other States. These unique factors are:

1. Victoria deploys a capital improved value for the purposes of value assessments resulting in the improved value of land (ie building) being captured in the rate assessment.
2. The CFA has developed a risk rating system for Victorian properties, that provides a risk rating for property based upon land-use, location, slope, building materials and a range of other factors.

These two factors alone create the potential for an equitable funding system that would cater for revenue collection based upon risk exposure and property value and therefore the probability of having to call upon the funded fire service.

Victoria's access to improved value as a basis to calculate an FSL contribution would negate any potential avoidance of FSL contribution based upon selecting a deliberately low sum-insured and low insurance premium.

Therefore, the Insurance Council considers that a property-based fire services funding system, which appropriately takes account of fire risks, is preferable to the current insurance-based system and is similar to the method adopted successfully in other jurisdictions.

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

A single fund is used successfully in South Australia and Western Australia. The advantages of such a system are improved transparency of management of the fund, budgetary processes and a reduction in transactional costs. The unique identity, role and needs of each respective service can be preserved within the operation of a single fund and should not be considered a disadvantage.

In addition, a common fund will inevitably result in savings in transaction costs and economies of scale and scope in non front line activity. These savings can be transferred for use in front line activity. On the other hand, a common fund may suffer from integration problems and in particular, in the case of the MFB and CFA, the integration of professional and volunteer fire fighters.

The Insurance Council believes that there are some significant advantages in funding the MFB and CFA from a central fund.

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

The concept of a mandatory insurance might appear to offer a simple solution to under-insurance and non-insurance. However, any compulsory scheme would present significant policy challenges, would remove personal choice and resulting risk adaptation, and would displace the operation and benefits of an efficient private insurance market in Australia.

A number of immediate issues arise with respect to compulsory property insurance. These include:

- (a) In the event that the insurance was privately underwritten, the need to establish a complementary regulatory and pricing framework that would regulate such matters as minimum sums insured, perils covered, appropriate pricing etc. Where privately provided compulsory cover exists for other insurable losses (i.e. CTP) these arrangements are managed by a State regulator (i.e. the NSW Motor Accidents Authority).
- (b) In the event that such a scheme was to be publicly underwritten, then the appropriate insurance "base" would need to be settled. For example, in the case of New Zealand such compulsory cover is provided as an adjunct to rateable land holding. To ensure the challenges of non insurance and underinsurance do not arise in another form, the base determined needs to be comprehensive and broad and not easily evaded.
- (c) In the event that such a scheme was to be publicly written, appropriate access for consumers would need to be developed. Private insurance is presently available through many channels that are convenient for consumers. These channels include brokers, banks, retail outlets, the internet, stock & station agents and even supermarkets.
- (d) The need to determine what perils and covers are available under the compulsory scheme and that these insurances do not "crowd out" existing private cover. For example, would the scheme only cover bushfire risk (as defined by law) or would it cover other catastrophes? What powers would be available to a government to "declare" a peril covered by the compulsory insurance? What compensation would be made available – a flat "cap" or open ended according to loss experienced? What scope would be there to take "top up" cover etc

The voluntary adoption of private insurance by consumers is an essential part of personal risk mitigation and behavioural adaptation through the setting of price signals against everyday decisions and activities that occur in a modern society (eg. driving a car, owning property, running a business).

Personal choice and decision making with regard to the adoption of private insurance or other risk offset mechanisms (eg, modifying behaviour by ceasing a risky activity, or putting aside savings for future potential risks) is a core component of building personal and community resilience to risks.

The alternative position is the creation of a fiscal environment, through compulsory insurance, where such decisions, and therefore the considerations and responsibilities around modifying risk behaviour through mitigation and/or adaptation activities, are taken from the hands of individuals and businesses. Consumers may also choose to opt-out of purchasing insurance in order to pursue alternative risk offset measures that are better suited to their lifestyle choices. Some individuals will always 'self-insure' for genuine financial, cultural or philosophical reasons.

Importantly, private insurance can also send critical price signals to the community about behaviour and risk mitigation. High risk construction in locations actuarially prone to a greater incidence of natural disasters will typically attract a higher cost for offsetting those risks through insurance. For many consumers lifestyle choices outweigh the financial impost of protecting the lifestyle they have chosen and an informed decision is made. For other consumers the cost of insurance may inform subsequent decisions to modify a lifestyle through risk mitigation.

Insurers compete in terms of price and product, which are in turn informed by actuarial knowledge. The existence of a competitive private market, delivering a wide range of choices to consumers, establishes an environment where consumers can compare different actuarial views of the risks in their location (through the prism of products and premiums), providing greater credibility to the decision they ultimately make to accept risks or undertake mitigation actions. Comparison of knowledge of the risks is critical to individuals making a credible and active decision to insure.

Statutory insurance would necessitate extensive regulatory intervention in pricing, distribution and service delivery. Cross-subsidies on equity or affordability grounds dampen price signals for the community and remove incentives to mitigate risk. A statutory scheme would displace the private market therefore removing the competitive forces that presently create choices for the consumer.

Rather than explore the potential to create a new government insurance scheme, the Royal Commission should consider those issues that inhibit individuals from protecting themselves, from considering their circumstances and from taking out an appropriate level of private cover.

For these reasons, the Insurance Council does not consider this option to present a viable solution to the problems associated with the current FSL system.

## **BUILDING and CONTENTS INSURANCE**

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

A number of speculative statements regarding the level of non-insurance and under-insurance among those affected by the 2009 bushfires have appeared in the media, to arrive at verifiable multi-source estimation, integration of datasets held by industry and government agencies would be necessary.

From an insurance industry perspective, the claims experience by reporting insurers has indicated a high level of under-insurance in the Victorian community. In Suncorp's submission to the Royal Commission under-insurance levels were observed as follows GIO 56% of consumers were under-insured, Suncorp 56%, APIA 74%. Many other insurers have remarked that the high rate of cash settlement (approximately 90% as at 30/11) compared to the very low rate of insurer orchestrated rebuilds is largely symptomatic of claimants having insufficient insured sums in order to progress with rebuilding. Naturally, this observation needs to be qualified by the likelihood that there are some people affected by the 2009 bushfires who, despite having adequate insurance, received cash settlements following a decision not to rebuild in the wake of the bushfires. This is information that the insurance industry does not hold.

Further underscoring the prevalence of under-insurance issue is the analysis of total insurance claims reporting carried out by the Insurance Council to track and report to government the performance of insurers in the claims environment. This dataset shows that the average insurance claim value for residential property (total loss) arising from this event is \$132,000, whilst the average cost of building a property in Victoria is \$230,000. This indicates an average \$98,000 shortfall for rebuilding purposes or 42% potential deficit.

From a non-insurance perspective, the Insurance Council has undertaken the most extensive, robust and comprehensive analysis into non insurance in Australia using the most reliable statistical sources available including the Roy Morgan Single Source Survey and the Australian Bureau of Statistics Household Expenditure Survey (**HES**) including confidential unit record files.

From this analysis, the Insurance Council estimates that there are approximately 51,000 owner occupied households not paying body corporate fees that do not purchase any form of building insurance. This

represents a non insurance “rate” for buildings of some 4%. Of the 51,000 households, some 35,000 reside in the Capital City (as defined by the ABS) with the remainder (ie 16,000) residing in the remainder of Victoria. The Insurance Council has also identified that the total value non insured Victorian housing assets for owner occupiers not paying body corporate fees is approximately \$13.5 billion, with the majority of these assets held by those with an annual household income of less than \$38,000. In other words, a significant proportion of non insured housing assets are held by households who have limited financial capacity to recover in the event of a total loss.

This analysis of non insurance in Australia can be found in the Insurance Council’s 2007 study: “The Non Insured: Who, Why and Trends” and in several submissions to various taxation reviews including the Submission to the Victorian Parliamentary Economic & Development and Infrastructure Inquiry into State Government Taxation and Debt lodged in October 2009.

The Insurance Council considers that Victorian government agencies mobilized for the bushfire relief effort are best placed to profile the demographic profile and expenditure patterns (including the purchase of insurance) for victims of the Victorian bushfire. This is due to its understanding that those victims of the 2009 bushfires who received government assistance were required to provide the agencies with profile information (including insurance details) before that assistance was provided.

The Insurance Council contends that a detailed and comprehensive review of the data collected from these agencies would enable the Royal Commission to better understand aspects of the demographic and behavioural factors that may have contributed to non insurance and underinsurance in the bushfire zones.

Such a comprehensive study would review the records collected as part of the Victorian relief/welfare effort (including demographic information); the claims and insurance profiles of affected households as well as data from the relevant State revenue offices with respect to the take up of particular stamp duty relief exemptions. In this regard, the Insurance Council submits that a detailed and comprehensive study based on such data sources would be invaluable in better comprehending decision making around risk and in particular, how households respond to risk and the factors that drive decision making.

Therefore, the Insurance Council recommends that the Royal Commission request that the Victorian Government and, in particular, those government agencies mobilized for the bushfire relief effort provide to it the data collected by those organisations on the levels of non-insurance and under-insurance of those affected by the 2009 bushfires.

### **What reasons, if any, are there for government to ensure residents in bushfire prone areas are adequately insured? What form should government involvement take?**

The obvious reason for government ‘encouragement’ of residents to take up adequate insurance is to avoid becoming the public default insurer. Encouraging resilience in individuals alleviates residual pressure on the public purse as more individuals are able to execute their own recovery, rather than rely upon taxpayer funds. Government involvement should be strongly focused on four issues:

- Removal of obstacles to individuals taking out private insurance (remove taxes)
- Provide adequate risk information to individual property owners, so that an appropriate risk based decision can be undertaken
- Increase the level of financial literacy and community understanding around the need to be resilient and to undertake financial risk management on a personal level.

Therefore, the Insurance Council submits that the Royal Commission should support measures to encourage the take-up of adequate insurance in bushfire prone areas and elsewhere and it should conclude that this will be greatly assisted by the removal of the FSL.

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

As insurers typically add the FSL to the premium in a similar way to stamp duty and GST, the removal of the FSL will not impact the base premium but will significantly reduce the overall cost of insurance for the insured. The Insurance Council has undertaken the only known extensive analysis into the effects of removing State insurance taxes on insurance premiums. This research is included in the study by Dr Richard Tooth “An Analysis of the Demand for House and Contents Insurance in Australia” and was completed in 2007.

This study indicates that of the 51,000 hitherto mentioned Victorian households who do not purchase building insurance, some 30,000 households would purchase insurance (i.e. a 60% decline) if state taxes on

insurance were abolished. It follows that those who currently are forced by virtue of premium costs to underinsure, would be similarly encouraged to take out more appropriate levels of cover in the event that the FSL was removed.

It should be noted that the elasticity study into demand for house and contents insurance was not available at the time of the 2003 review of the fire services funding system undertaken by the Victorian Department of Treasury & Finance.

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

The discussion paper refers to a 2005 ASIC review of under-insurance which makes recommendations regarding how insurers can assist individuals with tools to estimate building values.

However, the discussion paper does not reference ASIC's 2007 follow-up to the review (ASIC Report 89 "Making Home Insurance Better" January 2007) which identifies that many insurers subsequently adopted the recommendations to assist in reducing under-insurance. The 2007 ASIC report notes that:

*"Most insurers have taken steps to improve the tools available to consumers and help address the risks of underinsurance. However, consumers also have a responsibility in reducing the risk of underinsurance via the type of insurance they purchase and, where relevant, by using the available tools to select the appropriate level of cover." – Page 8.*

Whilst insurers can and do provide guides, calculators and tools to assist a potential client in determining the value of their home, the home-owner will ultimately be the only person able to make a decision regarding value. There is a considerable asymmetry of information involved in these circumstances. Home-owners will ultimately be the best placed party to be aware of special or luxury materials used in their property and of the relative quality/value of fittings and furnishings. Collecting this information during an application process, in order to determine or suggest a value to be insured would be a prohibitively complex process and one better suited to other bodies. Government agencies operating in the building environment, such as the Victorian Building Commission, may be best placed to develop and maintain guidance for property owners regarding the replacement or rebuilding costs of existing properties.

It should not be forgotten that additional post-disaster factors also contribute strongly to the under-insurance syndrome. Additional sudden escalations to building codes and standards, often to prevent a repeat of the damage, immediate changes to local land-use regulations and a need to bring replacement buildings up to existing standards (when they were built prior to those standards existing), all combine to significantly increase the cost of rebuilding in a disaster environment. Many disaster events are also coupled with a subsequent and significant increase in building materials and labour costs as property owners compete for limited building resources.

Some policies exist that offer 'full replacement' for buildings. These policies tend to rely upon additional information collected at the time of application for cover. The potential client is presented with a premium cost and no sum insured, guaranteeing that the property will be rebuilt to its current and known standard. These policies are not common in the marketplace as many consumers deliberately choose a lower sum-insured in order to limit the premium payable. Given that the premium payable is grossly impacted by taxation in Victoria it could be asserted that these policies may become more popular in an environment where premium is tied to risk and value alone, and not inflated by FSL.

The insurance Council contends that the Victorian Building Commission may be best placed to produce a reference guide or checklist for consumers to use in estimating the rebuilding cost of residential properties in Victoria.

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

In general practice, bushfire risk forms only a small component of the overall risk calculation for a property if one is included at all. The bushfire risk is often eclipsed by the risks of accident, internal fires, theft, storm, hail, wind and flood. Several insurers operating in the Australian market have indicated that they do not include any explicit rating for bushfire risk as part of the overall risk calculation for a property. Commercial considerations of market share acquisition as well as risk aggregation & distribution can also combine to further dilute the influence that bushfire risk in itself has over the price of a premium. The Insurance Council is in the process of preparing further evidence on this issue for the benefit of the Royal Commission.

In practical terms this is for two reasons. Firstly, calculation of the bushfire risk in detail would require exhaustive questioning of the client or access to existing government datasets. Commercial observations from residential insurers demonstrate that many clients prefer simplicity and quickly grow tired of lengthy application processes. In order for bushfire risk to be incorporated to a greater extent, a consistent dataset would need to be available that does not impact upon to consumer through a collection process.

Secondly, government datasets held by agencies such as DSE or the CFA regarding the relative risks of specific parcels of land or fuel reduction activities as undertaken, are unavailable to the insurance industry despite the 'prime beneficiary' status. Datasets, such as Bushfire Attack Levels as ascribed to properties, would enable insurers to incorporate the risk without relying upon consumers' interpretation of their own risks.

This relatively low attribution for bushfire risk undermines the practical value of the current FSL system as being risk based.

A more practical outcome for Victorian property owners would be the establishment of a state wide bushfire risk rating system for properties. A baseline rating may be calculated by the CFA using the currently available risk engines that rely upon on slope, distance to vegetation and building materials. This data could be made available to property owners as part of existing Section 32 processes. A second tier rating, or adjustment to the primary rating, could be granted upon examination of any specific (and accepted) fire risk mitigation activities, for example fire fighting equipment, fire resistant building etc. A risk & value based FSL could then be easily applied through property levies.

The true beneficiary of fire risk mitigation and fire services are property owners. The Insurance Council submits that the Royal Commission should recommend the adoption of a robust bushfire risk rating system of Victorian properties that is then made available to property owners (and renters) through existing Section 32 processes. Such information would in the first instance allow appropriate risk based decision making and in the second instance it would facilitate an equitable contribution to the funding of fire services based upon risk and value.

## CONCLUSION

The Victorian community deserves a first class fire fighting service to assist in protecting their lives and their properties.

However, the funding of such a service should be equitable and shared by all property owners who receive benefit of the service. The funding mechanism should not discourage the adoption of other critical risk mitigation such as the adoption of adequate private insurance cover, as the present system does. As has been reflected in submissions from the community and through the Victorian media, it is appropriate to change the basis of funding for these services now and to by the same stroke encourage greater preparation in the community through adoption of affordable private insurance cover.

The Insurance Council maintains that the Royal Commission ought to determine that the present FSL scheme should be abandoned by the Victorian State Government in favour of a revenue scheme that applies to all property owners, that does not discourage the adoption of an appropriate level of insurance cover by individuals and incorporates an appropriate level of risk rating that is presently not incorporated through an insurance based FSL.

**11 January 2010**

## Annexure A

<b>Australian Jurisdiction Comparisons of Fire &amp; Emergency Services Funding</b>	
Western Australia	Property based system with emergency service levy applied on the gross rental value of all immobile properties. No levy imposed on motor vehicles. State is divided into fire levy categories according to level of service (i.e. extent of emergency service provision and access) with Category 1 (i.e. Perth) through to Category 5 (remote WA). Minimum charge of \$43 with maximum levy payable by households of \$225 and commercial property owners \$130,000. Levy collected by local government.
South Australia	System introduced in 1999. Emergency Service Levy levied on capital values for fixed property and also on motor vehicles and other mobile capital. Levy on fixed property is a fixed fee (\$50) plus a variable component. Variable component derived from capital value, an "area factor", land use "factor" and the levy rate. For motor vehicles a fixed fee applies (eg \$24 for cars and large capacity motor cycles). The SA Transport Authority collects the levy from motor vehicles while the SA State Revenue Office collects the levies from properties. Concessions for seniors apply.
Queensland	Qld Fire & Rescue Service funded through an Urban Fire Levy on properties. Urban Fire Levy contributes 73% of funding with State government and user charges making up the remaining proportion. Amount of levy is dependent on the "class" of the urban district (i.e. where the property is situated); the activity carried on the property or the use to which the land is used and the size and nature of any improvements on the land. (using the local government guide to classification of properties). The latter two factors determine the fire levy "group". Once the appropriate fire levy group and urban class is determined, the amount payable is set out under Schedule 2 "Annual Contributions of Owners of Prescribed Properties", Qld Fire & Rescue Service Regulation 2001
Victoria	Statutory contributions system. Metropolitan Fire Brigades Act 1958 requires insurers to contribute 75% of Metropolitan Fire Services costs, with local government paying 12.5% and State government 12.5%. Country Fire Authority Act 1958 requires insurance industry to pay 77.5% of CFA budget with State Government paying 22.5%. MFB & CFA Contributions Regulations applies a weighting of 40% to domestic insurance and 80% for any other insurance against fire (ie that for domestic policies 40% of premium is subject to contributions and for any other insurance against fire, 80% of premium is subject to contribution.)
NSW	Statutory contributions system. NSW Fire Brigades Act 1989, Rural Fire Services Act 1997 and State Emergency Services Act 1989 requires insurers to contribute 73.7% of funding, with local government paying 11.7% and State government 14.6%. Schedules to the Acts provide a weighting of 50% to domestic premiums and 80% for other property insurances, insuring against fire. (i.e. that for domestic policies 50% of premium is subject to contributions and for any other insurance against fire, 80% of premium is subject to contribution).
Tasmania	Statutory levy model. Levy on insurance of 28% of gross premium for all commercial insurances against fire, including contractors all risk. For marine and cargo insurance levy is 2% of gross premium and for aviation 14% of gross premium. Local government levies assessed on annual value of properties with minims charge applicable. Charge on motor vehicles of \$14. Concessions available to pensioners.
ACT	Property based system. Residential and rural properties \$91.20 with commercial properties levied on the basis of the average unimproved land value over three years.

## Annexure B

<b>International Comparisons of Fire Services Funding</b>	
United States	States and local government's in the United States use a variety of methods to fund the professional fire services. The most common taxes supporting fire and emergency services in the US are property taxes usually levied at a set rate per dollar of assessed value. However, local authorities also adopt innovative measures such as Howland, Ohio which have implemented a "bed tax" to generate revenue for the Howland Fire Department. In the State of Washington, fire districts are authorised to utilise a service charge based on measurable benefits to property with the "benefit" charge a function of the type of occupancy, insurance reduction, fire flow requirements and distance from fire stations. Other local authorities utilise specific user charges to meet demand for fire services and at the same dissuade foolish behaviour such as driving through flood zones. Casper, Wyoming charges a fee for hazardous material call outs. Ventura, California has established guidelines for recovering the costs of certain "preventable" fire events such as discharging a fire arm that results in a fire; inadequate control of open burning; juveniles playing with fire and the misuse of alcohol or controlled substances that lead to fire and emergency call outs.
United Kingdom	The London Fire Brigade is an arm of the London Fire & Emergency Planning Authority (LFEPA) with all 17 members of the LFEPA appointed by the Mayor of London. In 2007/08, the London Fire Brigade was funded by a combination of grants from central government (£ 254.4 m) and the remainder from funding from London boroughs (£ 137.0 m) primarily through taxes on property.
Canada	There are approximately 3,500 Fire Departments in Canada of which around 3% are full time and 91% volunteers. Of the 108,000 estimated fire services personnel 22% are full time and the remainder volunteers. Primary responsibility for fire and emergency services is the responsibility of cities and municipalities. For example, fire services and emergency services in the City of Toronto is coordinated by the Office of Emergency Management. The Toronto Fire Services provides "all hazard" assistance and is funded and mandated by the City of Toronto. 40% of the City of Toronto is funded by property taxes, with federal and provincial subsidies making up an additional 25% of funding. The Vancouver Fire & Rescue Service is a department of the City of Vancouver and was funded to the amount of \$88 million by the City. The City of Vancouver recovers the bulk of its revenue from taxes on property.
NZ	New Zealand Fire Service is funded through the imposition of a fire service levy on insurance policies to the value of 7.6 cents per \$100 of insured value for residential, commercial and personal property (with a cap of \$100,000 for residential property insurance, \$20,000 for personal property and no cap for commercial). Motor vehicles under 3.5 tonnes are levied a flat rate of \$6.08 per vehicle.