



2009 Victorian Bushfires
Royal Commission

Response to Discussion Paper – cover sheet

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Response
2009 Victorian Bushfires Royal Commission
GPO Box 4358
Melbourne VIC 3001

Or

Email your response with this cover sheet to: enquiries@royalcommission.vic.gov.au

Title: Dr	First Name: James	Surname: Popple
Organisation represented by your response (if applicable):		
The Commonwealth of Australia		
Email address:	[REDACTED]	
Postal address:	[REDACTED] BARTON ACT 2600	
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Main topic(s) addressed by your response (please tick:)	<input checked="" type="checkbox"/> Insurance	<input checked="" type="checkbox"/> Fire Services Levy

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Date: 21 December 2009

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COMMONWEALTH RESPONSE

FIRE SERVICES LEVY AND INSURANCE DISCUSSION PAPER

DECEMBER 2009

The Commonwealth welcomes the opportunity to comment on the November 2009 *Fire Services Levy and Insurance Discussion Paper* (Discussion Paper) prepared by the 2009 Victorian Bushfires Royal Commission (Commission). The Commonwealth does so on the understanding that its response may be used by the Commission to inform its identification of issues that may be examined through evidence before the Commission during 2010.

2. Although the Commonwealth regulates the general insurance industry through various pieces of legislation, including the *Insurance Act 1973* (Cth) and the *Insurance Contracts Act* (1984), the Discussion Paper addresses matters that are primarily the responsibility of States and Territories and the insurance industry more generally.

3. The Commonwealth's response to the Discussion Paper is limited to general matters that the Commonwealth considers would assist the Commission identify issues that may warrant further examination before the Commission.

Fire services levies and stamp duty on general insurance

4. Fire services levies and the imposition of stamp duty on general insurance increase the cost of insurance policies and can deter people and businesses from purchasing adequate levels of insurance. As the Discussion Paper notes this outcome has the potential to exacerbate inequitable results for some members of the community, including those on lower incomes who are most likely to under-insure or be priced out of the market and who are also least able to bear the costs privately in the event of a loss.

5. The equity of fire service levies and stamp duty on general insurance has been considered in previous reviews. Notably, in its final report to the then Commonwealth Government, the HIH Royal Commission recommended that State and Territory governments abolish stamp duty on general insurance products and that States that have not already done so abolish the fire services levies on insurers.¹ The HIH Royal Commission found that ideally, the cost of providing fire services levies should be met by all property owners and noted that this issue was also considered by the Victorian Review of State Business Taxes in 2001. The Victorian review found that, shifting the funding for fire services away from those who currently insure their properties to all property owners, as a separate item on local government rates notices, would achieve greater equity in supporting fire services.²

Australia's Future Tax System Review

6. On 13 May 2008, the Commonwealth Government announced the *Australia's Future Tax System* (AFTS) review. The panel conducting the AFTS review is chaired by the Secretary to the Treasury, Dr Ken Henry.

¹ See recommendations 55 and 56 of the Final Report of the HIH Royal Commission at: <http://www.hihroyalcom.gov.au/finalreport/Chapter%2010.HTML>.

² Ibid.

7. The AFTS Review is conducting a comprehensive examination of Commonwealth and State government taxes and interactions with the transfer system. The terms of reference of the AFTS Review state that the review will examine and make recommendations to create a tax structure that will position Australia to deal with the demographic, social, economic and environmental challenges of the 21st century and enhance Australia's economic and social outcomes.

8. Of particular relevance to the discussion paper, the AFTS review is considering State taxes on insurance, including the fire services levies in those States where insurance providers contribute to the funding of fire services. The AFTS review panel is scheduled to provide its final report to the Treasurer, the Hon Wayne Swan MP, in December 2009. The Commonwealth Government will consider the recommendations of the review before releasing its initial response in early 2010. Any reforms to State and Territory taxes that are proposed in the review would require cooperation and coordination between the Australian Government and the States and Territories.

9. If the AFTS review and the Commonwealth Government response to it touch on matters of relevance to this discussion paper, the Commonwealth Attorney-General's Department, which is coordinating the Commonwealth's involvement in the Commission, will draw it to the Commission's attention.

Building and contents insurance: non-insurance and under-insurance

10. Despite initiatives of governments and the insurance industry, issues of non-insurance and under-insurance continue to affect those impacted by natural disasters. Previous inquiries and investigations have revealed the extent of these issues and made various recommendations to address them. While the non-insurance of properties does pose difficulties, the Commonwealth notes that in the wake of previous large-scale disasters, such as the 2003 Canberra bushfires, under-insurance is often the biggest problem policy holders face in the rebuilding process.

11. In particular, the 2004 Council of Australian Governments *National Inquiry on Bushfire Mitigation and Management* (COAG Inquiry) found at finding 9.1 that:

the insurance industry should provide improved and more consistent advice to policy holders on how to ensure that their level of insurance cover for buildings and contents meets the full replacement cost,

and recommended at recommendation 9.2 that:

the insurance industry should provide improved and more consistent advice to policy holders on how to ensure that their level of insurance cover for buildings and contents meets the full replacement cost.³

12. Similarly, the 2003 House of Representatives Select Committee on the Recent Australian Bushfires report, *A Nation Charred: Inquiry into the Recent Australian Bushfires* (Nation Charred Report), recommended:

that the Insurance Council of Australia coordinates a public education campaign aimed at illustrating the importance of asset protection and how this can be achieved (that is, insurance products) (recommendation 45),

³ Full COAG *National Inquiry on Bushfire Mitigation and Management* report can be accessed at <http://www.coagbushfireinquiry.gov.au/findings.htm>.

that insurance companies ensure that potential and existing policyholders are aware of the need to regularly review their insurance policies to prevent undervaluing. This could be done through renewal notices and quarterly reminders. This should include a list of bushfire risk reduction measures that policy holders can implement to decrease the cost of their premium (recommendation 46).⁴

13. The Australian Securities and Investments Commission (ASIC) has published two reports dealing with issues arising out of the 2003 Canberra bushfires. The purpose of these reports was to investigate the causes of under-insurance revealed in the aftermath of the bushfires. In September 2005, ASIC's report *Getting home insurance right* found that these causes included:

- most home buildings insurance policies pay "sum insured" on total loss and therefore place the onus on the consumer to calculate rebuilding costs
- only a small number of insurers provided consumers with reliable tools for estimating these rebuilding costs, and
- rebuilding costs may change at a greater rate than annual increases in the sum insured.

14. In a follow up report in January 2007, *Making home insurance better*, ASIC reported on initiatives taken by the insurance industry in response to these findings. ASIC also commented in this report about the experience of Cyclone Larry in March 2006 where there were initial estimates of underinsurance affecting up to 50% of affected houses, and that this was exacerbated by the impact of significant reported increases in rebuilding costs immediately after the disaster and increased building code compliance costs.

Industry action to address under-insurance

15. In recent years, the insurance industry has changed some of its practices and developed a range of initiatives to address under-insurance. Most notably, the insurance industry reviewed its code of practice in response to the lessons learnt from the claims arising from the 2003 Canberra bushfires. The Insurance Council of Australia adopted:

- recommendation 46, above, of the Nation Charred Report
- recommendation 45 of the Nation Charred Report regarding the coordination of a public education campaign aimed at illustrating the importance of asset protection and how this can be achieved, and
- finding 9.1, above, of the *National Inquiry on Bushfire Mitigation and Management*.

16. A key development in the insurance industry that the 2007 ASIC report noted was the introduction by a few insurers of home building policies providing broader cover for consumers, such as total replacement policies and extended replacement cover policies. Total replacement policies ensure that consumers are adequately covered – if their home is accidentally destroyed their insurance will pay to rebuild it. Under an extended replacement cover policy, the insurer will pay up to a pre-agreed percentage over the sum insured, if necessary to meet the higher costs of rebuilding following a mass disaster. Typically, the additional amount is 20%–50% above the sum insured. Other changes adopted by the industry included the use of higher indexation rates to increase the sum insured on renewal and that most insurers had implemented education strategies to communicate with consumers about underinsurance.

⁴ See recommendation 46 at <http://www.aph.gov.au/House/committee/bushfires/inquiry/report/front.pdf>.

17. ASIC also found in 2007 that while some insurers continued to offer simple cost-per-square calculators to estimate sums insured, sophisticated web based calculators that give a more accurate estimate of rebuilding cost were available.

18. ASIC has encouraged the insurance industry to continue to make improvements in these areas, particularly by investigating the viability of more widespread introduction of total replacement and extended replacement policies. While these matters are ultimately decisions for individual insurers, ASIC will continue to monitor these industry developments.

Property owner assistance and education

19. Financial literacy initiatives, such as encouraging consumers to regularly review levels of insurance cover and to shop around to obtain the best value for money insurance products, can reduce levels of non-insurance and under-insurance.

20. The Commonwealth has a role to promote financial literacy and community awareness about insurance. The Commonwealth promotes financial literacy through:

- the Understanding Money website, <http://www.understandingmoney.gov.au/>, which includes information on how an individual might ensure they have adequate insurance cover, and
- the consumer website of ASIC (FIDO), <http://www.fido.gov.au/fido/fido.nsf>, which sets out information about insurance, including under-insurance.

21. Insurers also have a key role in educating consumers about their own products, including to re-evaluate their sum insured each time they renew their policy, for example in light of increased construction costs and/or any renovations.

Compulsory Insurance

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