Uninsured Australia

The case for not-for-profit insurance

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Financial Inclusion Program

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The Brotherhood of St Laurence is a non-government, community-based organisation concerned with social justice. Based in Melbourne, but with programs and services throughout Australia, the Brotherhood is working for a better deal for disadvantaged people. It undertakes research, service development and delivery, and advocacy, with the objective of addressing unmet needs and translating learning into new policies, programs and practices for implementation by government and others. For more information visit <www.bsl.org.au>.

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1 Introduction

The Brotherhood of St Laurence (BSL) promotes social inclusion through the development of effective financial inclusion programs for low-income Australians, as well as advocacy for policies and programs that enable the building and protection of assets over the life course.

To this end BSL recognises that access to fair and affordable credit and financial services allows Australians to take advantage of both economic and social opportunities. For a large number of Australians access to these services and products is limited. Whether a result of family disruption, limited education, a poor credit rating or a lack of work, financial exclusion can have extremely serious consequences.

In 2014 the Fire Service Levy Monitor (FSLM), an entity established to oversee the transition of Victoria's fire service levy from insurance policies to municipal rates, entered a funding agreement with BSL. This agreement arose from levies which 56 insurers continued to collect from consumers after the transition date.[1] The Monitor acknowledged insurer difficulties in refunding all consumers and instead directed that amounts not refunded be used by BSL and several like agencies 'in support of consumer insurance issues'.

Over the past decade BSL has produced two reports into the lack of insurance among low-income Australians. In 2006 Genevieve Sheehan and Gordon Renouf in *Risk and reality*[2] surveyed the attitudes of 126 low-income earners and identified a lack of affordability as a primary deterrent. Five years later Dominic Collins in *Reducing the risks* proposed ways in which access to home contents and vehicle insurance could be improved.[3] As a means of protecting assets and preventing financial hardship, insurance provides a vital safety net, but those who are least able to replace their possessions or absorb a loss are also the least likely to be insured.

BSL resolved to use the FSLM funding to build on earlier work regarding the extent to which low-income Australians are uninsured and how a key concern of consumers, namely affordability, might be tackled. Barring government intervention, increased coverage is dependent on for-profit insurers. Herein lies an irreconcilable problem: the commercial instinct to maximise profit will always constrain the insurer's preparedness to offer a product at the most affordable price. By contrast, a dedicated not-for-profit (NFP) insurance platform might be, in certain circumstances and for some products, a suitable means of maintaining lower-priced products to those who need them most.

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[1] Fire Services Levy Monitor (FSLM) 2014, *Report to the Minister for Consumer Affairs, June quarter 2014*.

[2] Sheehan, G & Renouf, G 2006, *Risk and reality: access to general insurance for people on low incomes*, BSL, Fitzroy, Vic.

[3] Collins, D 2011, *Reducing the risks: improving access to home contents and vehicle insurance for low income Australians*, BSL, Fitzroy, Vic.

The idea of a specialist NFP financial services provider is not entirely new; Good Shepherd Microfinance (GSM) was established on this basis in 2012 to provide financial services and products, most notably no-interest loans. GSM has recently embarked upon partnerships with two major Australian insurers, which introduce a NFP component into insurance delivery. BSL welcomes these initiatives and believes they represent an important step towards a dedicated NFP insurance platform. A key lesson of the ventures will be whether the partnerships are able to maintain low-priced products through the cyclical pricing increases described in this report.

The paper does not explore the related issue of under-insurance, which was the subject of an earlier BSL submission proposing a hybrid government–private insurer response to the Commonwealth Government's Financial System Inquiry.[4] This is not to deny that under-insurance is undesirable especially among low-income Australians. Rather, it is to prioritise the development of more affordable, trusted insurance products in the belief that they will both build coverage levels and lower the incidence of under-insurance.

The paper aims to stimulate discussion about ways to remedy the current undesirable level of non-insurance in Australia. Further papers outlining the valuable role NFP insurance could play are planned in 2016–17.

[4] BSL 2014, *Response to Financial System Inquiry interim report*.

2 Insurance in Australia today

The Australian insurance industry's day-to-day operations are governed by the:

- *Insurance Act 1973*
- *Insurance Contracts Act 1984*
- Insurance Regulations 2012
- *General Insurance Supervisory Levy Imposition Act 2013*.

Another series of statutes governs insurer shareholdings, directorships and certain asset transfers.

The role of overseeing the industry sits with the Australian Prudential and Regulatory Authority (APRA), which monitors compliance across the insurance, financial and superannuation industries as well as collecting data from individual insurers. APRA produces periodic industry data on indicators including gross premiums, reinsurance expenses, gross claims, investment income and net profit/loss, capital base and excess capital.

APRA is funded via an industry levy. Insurers pay a charge according to a formula laid out in the annual General Insurance Supervisory Levy Imposition Determination. The minimum levy in 2015 was $7,500.

Within the insurance industry products are classified broadly as either life insurance or general insurance, the latter encompassing products such as accident, home (or building) and contents, compulsory third party personal injury (CTP), vehicle and travel insurance.

The Australian insurance market features more than 100 registered general insurers, of which four dominate: QBE, Allianz, IAG and Suncorp. Between them the quartet account for over 60 per cent of total premiums paid.

IAG brands include NRMA Insurance, CGU, SGIO, SGIC and Swann (Australia). Suncorp brands include AAMI, GIO, Bingle, Shannons, Vero and Apia.

Most insurers operating in Australia belong to the Insurance Council of Australia (ICA), whose members account for more than 90 per cent of total premiums written by private sector general insurers. Many insurers have adopted the voluntary General Insurance Code of Practice, the most recent version of which came into effect in mid 2014. [5]

APRA's 2013 General Insurance Supplementary Statistical Tables report that 22.5 per cent of Australian insurers' gross premiums in 2013 were derived from domestic motor vehicle owners in the form of optional coverage (i.e. other than CTP). This slightly exceeded the value of premiums generated by home owners (see Table 1).

[5] ICA website.

Table 1 Gross insurance premium by selected type 2013

Insurance type	Premium value ($ million)	Percentage of total gross premiums (%)
Domestic motor vehicle (non CTP)	7,354	22.6
Home owners/householders	7,095	21.8
Fire & industrial special risk	3,948	12.1
Public, product & professional liability	3,373	10.4
Motor vehicle CTP	2,740	8.4
Commercial motor vehicle (non CTP)	1,807	5.5
Travel	730	2.2

Note: The CTP figure represents the premiums received by private insurers operating in NSW/ACT and Queensland. In other states in 2013 CTP was provided by state-owned authorities whose operations are not governed by APRA. CTP is distinct from optional Third Party Property Insurance which provides coverage for damage arising from driver fault.
Source APRA 2013, *General insurance supplementary statistical tables*, p. 6.

Australia also has a small number of state-owned insurers, such as Victoria's Transport Accident Commission (TAC). The presence of statutory monopoly insurers like the TAC reflects the ebb and flow of insurance provision within Australian public policy. Commencing in the early 20th century governments in Australia, principally at state level, endorsed mandatory insurance forms such as workers' compensation and CTP, as well as establishing state insurance offices to facilitate product delivery. From the latter part of the century, budgetary pressures contributed to the sale of the insurance offices and, in some cases, ending of the states' retailing monopolies. Amid this wave of change, Victoria's TAC remained the state's sole CTP insurer. The contrast between the Victorian state-owned monopoly CTP scheme and the privatised NSW Greenslips[6] scheme in which motorists must purchase a product from one of numerous competing for-profit insurers is explored later in this paper.

[6] 'Greenslips' is the common name of the NSW compulsory third party insurance system, which requires motorists to purchase an annual 'greenslip' for their vehicle.

3 Low-income Australians and insurance: points of resistance

Over the past decade, research has identified the extent to which Australians are uninsured. The following reports echo the Australian Bureau of Statistics (ABS) Household Expenditure Survey which found that 23 per cent of private households in Australia lacked insurance coverage[7] and point to a continuing problem:

- ANZ's 2011 Survey of Adult Financial Literacy found that only 79 per cent of home owners maintained building insurance.[8]
- NAB's 2014 financial exclusion report provided a breakdown of the adult Australian population by key determinants, including general insurance coverage. It can be deduced from the report that 18.7 per cent of the population lacked general insurance coverage.[9]
- Citing the 2011 ABS Household Expenditure Survey, Good Shepherd Microfinance (GSM) in 2015 reported that 29 per cent of households and 67 per cent of Australian renters had no form of contents insurance.[10]

ANZ's ground-breaking 2004 report into financial exclusion identified how the non-insurance problem was compounded among low-income Australians, finding that around 40 per cent of individuals on incomes of less than $40,000 had no contents coverage.[11] Since that time other reports have confirmed the tendency of financially disadvantaged Australians, both home owners and renters, not to insure:

- A 2006 BSL study of 126 individuals, 80 per cent of whom were in receipt of Centrelink benefits, found only 45 per cent had contents or vehicle insurance.[12]
- A 2008 ACOSS report identified that more than half the adults on Newstart Allowance and Parenting Payment lacked contents insurance.[13]
- Collins' 2011 report found that only 21 per cent of Progress Loans clients had home contents insurance.[14]
- The 2011 ANZ Financial Literacy in Australia survey found that building insurance was less likely to be held by home owners earning less than $65,000.[15]

[7] FSLM 2014, *Enhancing the consumer experience of home insurance: shining a light into the black box*, p. 41. The paper cites the 2003–04 ABS Household Expenditure Survey.
[8] ANZ 2011, *ANZ survey of adult financial literacy in Australia*, p. 83.
[9] Connolly, C 2013, *Measuring financial exclusion in Australia,* Centre for Social Impact UNSW for NAB, p.18
[10] IAG 2015, *Innovative, affordable product to increase insurance accessibility*, media release, 1 October.
[11] Chant Link and Associates 2004, *A report on financial exclusion in Australia*, report for ANZ, p. 129.
[12] Sheehan & Renouf, op. cit., p. 5.
[13] ACOSS 2008, *Who is missing out? Hardship among low income Australians*, p. 20.
[14] Collins, op. cit., p. vii. Progress Loans was a joint ANZ–BSL concessional loan product designed for low-income consumers. It was trialled between 2006 and 2012.

A more detailed analysis of Victorian consumer attitudes to insurance, undertaken in 2014 for the FSLM, found that of Victorian home owners, 91 per cent had home insurance and 88 per cent had contents insurance while only 42 per cent of renters had contents insurance. Of the uninsured, an estimated 43 per cent were aged 18–34, with the majority of them (84 per cent) renting with lower average household incomes than insured owners or renters.[16] BSL believes that a higher rate of insurance coverage among low-income Australians is a desirable public policy objective as it would reduce the hardship that arises when assets are damaged or lost unexpectedly. Understanding why low-income Australians are more likely not to insure is essential if coverage is to be increased.

While affordability has been cited as a point of resistance to the uptake of insurance by low-income Australians, it alone does not adequately explain the coverage shortfall that is evident today. The following commentary seeks to distinguish the consumer recognition of affordability from other factors that are points of resistance in relation to both the offering and acceptance of coverage.

Affordability

A lack of affordability has long been recognised as a key reason why some consumers do not purchase insurance. In 2001 a NRMA commissioned survey found 22 per cent of respondents nominated the cost of home building or contents insurance as the reason they did not purchase a product.[17] Surveying one hundred Progress Loans clients a decade later, Collins found 69 per cent cited unaffordability as the reason they did not have more insurance cover.[18]

Affordability is partly a function of price: the lower the premium the more likely some consumers are to purchase a policy. The pricing of premiums is, because of the risk they address, subject to short-term fluctuation meaning that some consumers who purchase coverage this year may deem it unaffordable next year if the price rises.

Insurance affordability is influenced by pricing strategies. Counter-intuitive though it may seem, insurers do not always strive for the lowest product price in order to maintain their market share. In its analysis of insurer product pricing the FSLM noted the 'collar' or 'cup' strategy used by insurers to limit price decreases from year to year notwithstanding that input costs such as reinsurance may have declined. According to the FSLM:

> … it is accepted through the insurance industry that offering reductions in premium compared to the previous year can actually encourage a policy holder to shop around if the premium reduction is large.[19]

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[15] ANZ 2011, op. cit., p. 86.
[16] Hall & Partners 2014, Premium comparison aid, a research report for the Fire Services Levy Monitor, unpublished, p.21.
[17] NRMA 2001, *Home and motor vehicle insurance: a survey of Australian households*, p. 22.
[18] Collins, op. cit., p. 26.
[19] FSLM 2014, *Enhancing the consumer experience of home insurance*, p. 20.

On the flip side insurers are also mindful of the need to moderate premium increases from year to year lest this encourages customers to seek a cheaper alternative. Premium discounts of up to 25 per cent are also offered to new customers to encourage switching.[20]

Both Suncorp and IAG are tackling affordability by specifically designing products for low-income earners. Details of the new products are included later in this paper.

Stamp duty

State government stamp duty impacts the affordability of general insurance by inflating the premiums. Rates vary across jurisdictions from 4 per cent to 11 per cent[21] which, once the GST is applied, pushes premiums up by 4.4 to 12.1 per cent. Some other forms of insurance are taxed concessionally: stamp duty on crop and cattle insurance in New South Wales is only 2.5 per cent and duty payable on professional indemnity policies in New South Wales and Queensland is 5 per cent.

Australia's Future Tax System recommended all specific taxes on insurance products be abolished[22] but only the ACT has removed duty, the reform taking effect in mid 2016. The Victorian Government supported, in principle, the removal of insurance taxes.[23]According to the ABS more than $5.66 billion was collected in insurance taxes in 2013/14.[24]

The Insurance Council of Australia has estimated that if stamp duty were removed from insurance policies, 242,000 additional Australian households would take up home contents insurance and 38,000 would take up building insurance.[25]

Reinsurance

Reinsurance is an integral feature of Australia's insurance industry, allowing insurers both to reduce the volatility of year-to-year results and to manage their capital requirements. Australian insurers have long dealt with loss arising from unpredictable catastrophic weather events and bushfires which generate large numbers of simultaneous claims. Other products such as life insurance and CTP are far less volatile, with less year-to-year variation in the number of claims made.

General insurers protect themselves from the losses generated by catastrophic events through reinsurance, effectively a form of insurance for insurers. Should a high volume

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[20] ibid.
[21] Productivity Commission 2014, *Natural disaster funding arrangements*, p. 214.
[22] Department of Treasury 2009, *Australia's future tax system*, recommendation 79.
[23] ibid., p. 215.
[24] ABS 2015, *Taxation revenue*, Australia, 2013–14, Cat. no. 5506.0, ABS Canberra.
[25] ICA 2015, *$36 billion reasons to axe state insurance taxes*, media release, 27 August, http://www.insurancecouncil.com.au/assets/media_release/2015/August%202015/270815_$36%20billion%20reasons%20to%20axe%20state%20insurance%20taxes.pdf

of claims follow a bushfire or flood, the insurer can access funding provided through its reinsurance facility. Access to reinsurance is vital for insurers, as noted by Suncorp:

> As reinsurance intermediary Aon Benfield's catastrophe modelling arm, Impact Forecasting, noted, insured loss estimates from the Queensland floods (December 2010 and January 2011), Cyclone Yasi, the Perth hailstorm and the New Zealand earthquakes (February and June 2011) totalled $25.6 billion. It is estimated $16 billion will ultimately be recouped from the reinsurance industry.[26]

Commonwealth regulations recognise the importance of reinsurance to the viability of the industry. The relevant prudential standard requires a general insurer:

> … to maintain, as part of its overall risk management framework, a specific reinsurance management framework to manage the risks arising from its reinsurance arrangements.[27]

In early 2016 IAG announced a reinsurance arrangement that secured $7 billion of cover against flood, bushfire and hail. The agreement limited the company's direct exposure to catastrophe claims to $200 million, after which the reinsurance would provide the means to pay claims.[28] In the five years to 2015, IAG's reinsurance costs had risen by 92 per cent to $1.196 billion, while gross premiums rose less than 60 per cent. Following the 2011 Queensland floods, reinsurance costs were reported to have risen by around half.[29]

The cost of reinsurance therefore represents a substantial element in the price of insurance policies protecting consumers against catastrophic risks, especially building insurance. According to the FSLM reinsurance can make up between 20 and 45 per cent of the technical price of a policy. FSLM estimates of price components are listed in Table 2. The technical price differs from the retail price in that it reflects risk ratings, the expected value of future claims, reinsurance, administrative overheads and shareholder return. A separate set of commercial pricing factors, which may be positive or negative, is applied to the technical price in order to establish the retail price.

Table 2 Indicative allocation of shares of technical price to cost items for residential property insurance

Cost item	Share of technical price
Working losses	10 to 30%
Retained natural perils exposure	15 to 25%
Reinsurance	20 to 45%
Administrative and overheads	15 to 25%

[26] Day, A 2012, *Reinsurance – villain or hero?*, Suncorp, p. 2.
[27] APRA website.
[28] *The Australian*, 5 January 2016.
[29] ibid.

Cost item	Share of technical price
Cost of capital and return to shareholders	5 to 10%

Source: FSLM 2014, *Enhancing the consumer experience of home insurance*, p. 15.

As a capital management tool reinsurance serves insurers by allowing them, via an annual payment to a reinsurer, to accept more risk on the same capital base. Insurers choose the extent to which they use reinsurance in this way. APRA records that CTP insurance premiums paid to for-profit insurers in NSW, ACT and Queensland of $3.682 billion in the year to March 2016 came with reinsurance expenses of $561 million. By contrast, Victoria's TAC in 2014/15 recorded reinsurance expenses of only $879,000 against total premiums of $1.594 billion. The benefits of a heavier reliance on reinsurance accrue, however, only to the insurer; higher reinsurance charges push up the product's retail price. The contrast between NSW/Queensland and Victoria highlights a truth about reinsurance: where insurers choose, either for high risk mitigation or capital management reasons, to incorporate higher reinsurance charges into product prices, customers will find those products less affordable.

Availability

When insurance coverage in Australia is not mandated, consumers have the option of purchasing it but only where insurers are willing to offer coverage. This cannot be taken for granted. In its submission to the Productivity Commission inquiry into natural disaster insurance arrangements, Tablelands Regional Council drew attention to the plight of home owners who were unable to find an insurer willing to provide coverage.[30] At other times consumers may not find a product on terms acceptable to them. In investigating insurance industry practices in 2014, BSL inquired via RACV's online facility about the cost of a $5,000 contents policy. The insurer advised that 'it is most likely we would not provide contents insurance for $5,000 or $10,000'.[31]

Insurers may exercise the prerogative of declining applications for coverage more frequently in future as granular pricing (quotes based on local data) becomes better established. The FSLM noted that 'bushfire risk assessment is generally not yet as sophisticated as flood risk assessment', the latter having developed to the point where the National Flood Information Database carries data pertaining to about half the residential properties in Australia with a material risk of flooding.[32] Where data points to an extreme risk, insurers reserve the right not to offer coverage, as happened after the 2011 Queensland floods. Suncorp determined that the low-lying towns of Emerald and Roma were too exposed to flooding to justify offering flood insurance in those towns. The company's Chief Executive defended the decision by noting that between 2010 and 2012 the company had earned $4 million in premiums from policies sold locally but paid

[30] Productivity Commission, op. cit., p. 221.
[31] Email from RACV to Tony Robinson, BSL Senior Manager Financial Inclusion, 21 September 2013.
[32] FSLM, op. cit., p. x.

out $150 million in claims.[33] This decision was reversed in the case of Roma once a government-funded levee was constructed, leading to an average 30 per cent reduction on pre-flood premiums.[34]

The spread of the human footprint and climate change will likely make insurance availability more uncertain in future. Commenting on Brisbane floods, a Climate Institute report noted that 'the 1974 Brisbane flood inundated about 8000 properties [while] the 2011 flood of the same river system at one metre lower than 1974 impacted more than 25,000 properties'.[35] Population growth means increased hard surfaces and water run-off. As populations grow, infill development may accelerate, with developers offering cheaper, low-lying land for new housing.

Australians on low incomes are disadvantaged if insurers refuse to provide insurance on the basis of their property being more exposed to risks such as flooding. Where people's housing choices are restricted by income to lower lying areas, the inability to protect assets against an above-average risk of loss represents a public policy failure.

Product design and sales flaws

In some instances insurers have designed their products in ways that discourage take-up by low-income consumers. Industry practice heavily favours annual premium payment. The option of instalments, where available, usually incurs a surcharge; for example an RACV contents policy costs 20 per cent more if paid by monthly instalments rather than annually.[36]

Low-income Australians might find the (higher) instalment payment option necessary to avoid a single large payment, but instalment arrangements may bring an added risk. More interactions between the insurer and consumer increase the chance of an overlooked or missed payment leading to cancellation of cover. As BSL has previously noted, this circumstance gives rise to an insurer safeguard under the *Insurance Contracts Act*, namely:

> … the right to cancel an insurance contract due to an unpaid periodic premium payment where at least one instalment has remained unpaid for a period of at least one month and, before the contract was entered into, the insurer clearly informed the consumer in writing of the effect of this provision.[37]

Looking at the problems attributed to product design in the United Kingdom some years ago, researchers identified that while local insurers set a minimum contents policy coverage of £20,000, the average value of the contents of a single adult on a state

[33] *Courier Mail* 7 May 2012.
[34] Productivity Commission, op. cit. pp. 218–9.
[35] Cited in ICA submission to Productivity Commission review of natural disaster funding arrangements, 10 June 2014.
[36] BSL calculations derived from RACV website quotes.
[37] BSL (with others) 2011, *Submission to* Reforming flood insurance: clearing the waters *discussion paper*, p. 21.

pension was only £8,500. This would result in either significant over-insurance or a consumer deciding not to take up excessive cover.[38]

Recognising this impediment, the insurance industry has responded. In 2015 Good Shepherd Microfinance, in partnership with AAI, a registered insurer owned by Suncorp, established *Essentials*—special low-cost home, contents and car insurance products. *Essentials* includes contents coverage as low as $10,000 for $4 per week and all premiums can be paid by instalment at no additional cost.

In other areas insurers appear less responsive to customer needs. The 2014 FSLM analysis of insurance pricing noted that many customers are paying too much for insurance as a consequence of sales flaws. This is not to say the underlying product is deficient, rather that insurers are failing to adequately explain costs or offering an unnecessary feature. For example, one underwriter's quote effectively charged 33 per cent more for the monthly instalment option without any disclosure to the customer that this additional cost could be avoided. More disturbing was the following reference:

> … a representative of Allianz Insurance stated that 'we started our rollout in September 2012 and the customers that we've offered renewal to, to date, about 80 per cent have taken up the flood option'. It is accepted by the insurance industry that only (approximately) seven per cent of residential properties Australia-wide have any material risk of flooding.[39]

Complexity

The *Corporations Act 2001* requires product disclosure statements (PDS) to be issued with insurance policies and further defines the contents of the statements, although no standardised form is prescribed. Information must be 'worded and presented in a clear, concise and effective manner'[40], and insurers respond to this with highly detailed disclosure statements. The QBE motor vehicle PDS is 50 pages long and contains more than 12,000 words.[41] Allianz's *Classic Home Plus* PDS runs to 86 pages, 18 of which detail the insured events as well as other benefits Allianz will provide.[42]

One reason for the detailed PDS in both the insurance and non-insurance fields is the fear that anything less than this level of disclosure increases the risk of legal action by disgruntled consumers. In 2014 the National Australia Bank was fined by ASIC for potentially misleading statements in an Annuity Term Deposit PDS.[43] Providing more information reduces this risk, albeit at the expense of making insurance products more confusing for some consumers.

[38] Demos & SAFE at Toynbee Hall 2005, *Widening the safety net*, p. 14.
[39] FSLM, op. cit. p. 21.
[40] See section 1013C (3) of the *Corporations Act 2001*
[41] QBE website
[42] Allianz website
[43] ASIC 2014, *NAB pays $10,200 penalty for misleading statements in PDS*, media release, 1 October.

The lack of PDS conformity also makes a detailed comparison of competing insurance products very difficult.

The *Insurance Contracts Act 1984* requires insurers to provide key fact sheets (KFS) with their PDS. The sheets, prescribed in regulations pursuant to the Act, are typically one or two pages in length. While fact sheets help to make the terms and conditions of insurance contracts easier to comprehend they are not intended as a substitute for the PDS. Recently other efforts have been made to help consumers comprehend product details. For example, as part of its involvement in affordable insurance initiatives GSM makes available online an animated graphic to demystify complex policy information.

The challenge of addressing the cost barrier

In BSL's 2006 report *Risk and reality*, affordability was identified as the prime reason low-income Australians did not take out insurance coverage. From the consumer's perspective this is easy enough to understand: the higher the price of the policy the less likely someone on limited income is to afford it or at least believe they can afford it.

From the for-profit insurer's perspective, however, the issue is not easily addressed. Some reinsurance costs are impossible to control, customers will not all gravitate to cheaper online sales channels and Corporations Law PDS requirements are inflexible. Any for-profit insurer seeking to reduce product prices in order to build coverage must be prepared to weather those parts of the industry cycle that generate a surge in claims and consequential reduced profit margins.

What are the benefits of such a move for an insurer? As the next chapter notes, insurer returns have been resilient through an era of patchy coverage levels among low-income Australians. Lowering product prices to build coverage represents good public policy but to what extent, if any, can a for-profit insurer be expected to adopt this behaviour?

4 Strengths and weaknesses of for-profit insurers

In the absence of the Victorian or Australian government making specific forms of insurance coverage mandatory, the task of increasing coverage among low-income Australians falls to for-profit insurance companies.

As previously noted, Australia's insurance market is served by a large number of registered insurers. In its submission to the Financial System Inquiry, the Insurance Council of Australia noted that:

> At present, there are 116 insurers licensed to conduct general insurance in Australia, of which 104 are direct insurers and the balance reinsurers. In the 2013 year, the GI sector collected some $41 billion in gross premium. Direct insurers accounted for $39 billion of gross premium with the remainder accounted for by reinsurers. The total assets of the GI sector amounted to $113 billion with total liabilities, including outstanding claims liabilities amounting to $85 billion. Direct insurers enjoyed assets of $101 billion with total liabilities of $77 billion.[44]

A feature of the Australian insurance market is that four firms have a significant share, the ICA noting that IAG, Suncorp, QBE and Allianz accounted for more than 62% of all premiums in 2014. All four are listed companies, the first three on the Australian Stock Exchange and Allianz in Europe.[45]

The following characteristics of Australia's main insurers indicate both strengths and weaknesses in their ability to influence the level of coverage among low-income Australians.

The profit objective

Because general insurance deals with unpredictable risks, insurers set profit margin targets to ensure that low claim years generate sufficient profit to more than offset high claim years. Australian insurers typically aim for an underlying profit margin of around 14 per cent. In 2015 IAG achieved a 13.3 per cent return, slightly below the 13.7 per cent recorded a year earlier. The company's New Zealand division performed better, exceeding 19 per cent due to a lack of natural disasters.[46]

Few industries are impacted as directly and quickly by single events. The Reserve Bank's Financial Stability Reviews of 2014 and 2015 tracked a rapid change of fortune for Australia's general insurers. Aided by the lowest levels of natural catastrophe claims in two decades, the industry's annualised return on equity hit 17 per cent in the first half of 2014.[47] A year later the RBA noted 'historically high' natural catastrophe claims of

[44] ICA 2014, *Submission to FSI*, p. 7.
[45] ibid., p. 8.
[46] *The Age*, 19 February 2015.
[47] Reserve Bank of Australia 2014, *Financial stability review*, p. 29.

$3.5 billion which had sharply impacted on general insurer results.[48] In 2014/15 Suncorp and IAG profits fell by $254 million (25 per cent) and $479 million (30 per cent) respectively.

Unpredictability means general insurers occasionally face higher than anticipated claims. When the claims exceed expectations the insurer has a clear imperative; to achieve its profit margin target it can increase revenue by raising premiums. Although this works against the immediate interests of consumers it represents a vital response mechanism for insurers dealing with the vagaries of weather and fire. Other insurers dealing with less volatile risks, such as private health insurers, can live with the regimented premium increase process involving annual sign-off by the federal Minister for Health. General insurers would likely regard such a process as unworkable.

For-profit insurers do not, however, always align premiums with claims experience. If a 14 per cent return represents an acceptable result for a general insurer dealing with unpredictable catastrophic events, lower risk contingencies should be accompanied by steadier premiums. CTP insurance in New South Wales reflects premium pricing that is clearly unaligned with underlying risk. Between 2000 and 2010 the rate of accidents in New South Wales fell steadily, as Table 3 indicates.

Table 3 Key road accident metrics NSW

Metric	2000	2010	Change
Registered vehicles (million)	3.635	4.633	+27.5%
Number of crashes	52,914	42,299	–20.1%
Number of fatalities	603	405	–32.8%
Number of injured	28,812	25,055	–13.4%
Fatalities per 100,000 population	9.4	5.7	–39.4%

Source: NSW Motor Traffic Authority 2015, Road traffic crashes in NSW statistical statement for the year ended 31 December 2014.

Notwithstanding this marked decline, the numerous insurers offering CTP under the state's Greenslip scheme maintained very healthy margins. The NSW Auditor-General noted an extraordinary situation:

> Over the period from 2000 to 2010, about 50 per cent of CTP premiums was applied to pay claims, 19 per cent was retained by insurers as profits.[49]

The Auditor-General was not alone in making this observation; the NSW Government's 2013 CTP reform discussion paper also cited higher than predicted profit margins,

[48] Reserve Bank of Australia 2015, *Financial stability review*, p. 47.
[49] NSW Auditor-General 2013, *Insurance and compensation overview*, NSW Auditor-General's Report to Parliament, vol. 7, p. 12.

attributing these to the scheme's uncertain nature.[50] Research undertaken for the government revealed that for some years in the early part of the decade insurers maintained profit margins of nearly 30 per cent.[51]

So it can be seen that generous margins are both a strength and a weakness for for-profit insurers. The practice clearly enables them to satisfy prudential requirements about their ability to meet future claims, thus delivering a degree of confidence to government and policy holders. At the same time the pursuit of double-digit margins aggravates the consumer concerns about affordability. Notwithstanding a modest rise in the frequency of small claims, the generous profit margin is a factor in the near 70 per cent increase in CTP premiums since 2008, which has led to NSW motorists paying 45 per cent more than their Victorian counterparts for their mandated cover.[52]

That general insurers in Australia have been able, as the FSLM, NSW Auditor-General and NSW government have all observed, to maintain high profitability even during a period of significant natural disasters and a global financial crisis[53], points to a clear truth of modern listed for-profit insurers: they will prioritise the best possible return on capital over the affordability concerns of low-income consumers. Suncorp CEO Michael Cameron confirmed this corporate trait when he advised investors in early 2016 that an unexpected reduction in the company's insurance trading ratio necessitated the lifting of premiums as well as cost-cutting measures so that profit margins could be restored.[54]

Another less flattering example of the same behaviour is found in product-pricing changes in the transition of Victoria's fire services levy from insurance policies to municipal rates. The FSLM noted that:

> One insurer increased base premiums by an average of more than 35 per cent over a period of six months coincident with the removal of a similar amount of fire service levy.[55]

In this case the insurer determined that its obligation to maintain profitability outweighed its obligation to provide customers with a cheaper product, despite that being a clear intention of the Victorian Government's reform. Coming after an earlier industry declaration that the combination of potential fines, industry competition and 'our own corporate morality' would deter any such behaviour, the FSLM's revelation speaks to the strength of the for-profit sector's determination to maximise profits.[56]

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[50] NSW Motor Accidents Authority 2013, *Reforms to the NSW compulsory third party green slip insurance scheme*, p. 6.
[51] Ernst & Young 2013, *Selected indicators of the performance of the NSW CTP scheme to 2013*, p. 11.
[52] ibid., pp. 4–5.
[53] FSLM 2014, *Enhancing the consumer experience of home insurance*, p. xii.
[54] *Sydney Morning Herald*, 7 January 2016.
[55] FSLM 2014, *Enhancing the consumer experience of home insurance*, p. 4.
[56] *The Age*, 19 June 2013.

Shareholder demands

Achieving an adequate return on capital each year helps listed insurers maintain their profitability ahead of future periods of higher than average claims. At the same time it helps the company meet shareholder expectations of a steady and reliable flow of dividends. Australia's main insurers are popular among investors: QBE has 141,000 shareholders[57], Suncorp 184,200[58] and IAG 762,000 (which in 2014 made its share registry the fourth largest in the country).[59] Strategic objectives such as generating a return 'that is a multiple of at least 1.5 times the Group's weighted average cost of capital on a normalised basis'[60] are an understandable means of satisfying shareholders whose expectations are challenged with each disclosure of missed key performance targets. IAG's announcement of a less than anticipated first-half profit in early 2015 resulted in its share price falling by 8.45 per cent. Similarly, Suncorp's late-2015 readjustment of forecast earnings led to an almost 10 per cent reduction in its share price.[61] Circumstances like these necessitate a quick management response that assures shareholders their interests are being protected. In both 2015 and 2016 IAG responded quickly to unfavourable performance disclosures with declarations of unchanged interim dividends, allaying shareholder concerns but increasing pressure on the company to find alternative ways to recover profitability.[62] With natural disasters such as floods and fires widely expected to become more frequent in future general insurers will remain cautious about lowering their return on capital objectives. If anything, a move towards higher return on capital targets is more likely.

The disastrous 2011 Queensland floods exposed insurers to thousands of additional claims and their need to achieve benchmark returns on capital inevitably pushed them towards higher premiums. Notwithstanding the dramatic rise in the cost of reinsurance following the floods, the decision to quickly lift premiums allowed both Suncorp and IAG to continue paying healthy shareholder dividends. Table 4 charts the returns to shareholders from both insurers over recent years. Fluctuations are evident but through a period noted for its high incidence of natural disasters the performance of both companies, particularly the dividends paid to shareholders, improved dramatically between 2010/11 and 2013/14.

[57] QBE 2014, *Annual report*.
[58] Suncorp 2015, *Annual report*, p. 150.
[59] IAG 2014, *Submission to Productivity Commission natural disaster funding arrangements inquiry*, p. 5.
[60] IAG website.
[61] *The Australian*, 15 December 2015.
[62] See *The Age*, 19 February 2015 and *The Australian*, 18 February 2016.

Table 4: ASX listed insurance firm profits and dividends 2009–2014

	Suncorp		IAG	
	General insurance after-tax profit ($m)	Total dividend $	Insurance profit ($m)	Total dividend $
2008/09	462	0.40	515	0.10
2009/10	557	0.35	493	0.13
2010/11	392	0.35	660	0.16
2011/12	493	0.55	832	0.17
2012/13	883	0.75	1,428	0.36
2013/14	1,010	1.05	1,579	0.39
2014/15	756	0.88	1,100	0.29
2015/16	624	0.68	1,180	0.26

Notes: Because Suncorp operates both banking and insurance services it reports group profits and general insurance profits after tax. The latter figure has been used in the table. Total dividends include half yearly and final dividends as well as special dividends and returns of capital. QBE is not included in chart due to it reporting profit in $US and dividends in $A, as well as reporting on calendar rather than financial years.

The behaviour of listed Australian general insurers over recent years demonstrates a marked reluctance to allow periods of high claims and the consequential impact on profitability to disrupt their return to shareholder payments and it is unrealistic to believe this view will change. The raising of premiums to counter compromised earnings following natural disaster claim surges can therefore be expected to continue.

Shareholder interests have a different complexion when the value of listed insurance companies to Australia's superannuation industry is considered. Large-scale investment in insurance forms part of a vital national strategy to build retirement income for Australian workers, including low-paid workers. In 2015 Hostplus, an industry superannuation fund, held shares worth almost $60 million in QBE, over $45 million in Suncorp and $24 million in IAG.[63] The fund, with around $18 billion in assets in early 2016, is not the largest industry fund; Australian Super, LUCRF, HESTA and CBUS are all larger by asset value. They and other industry funds have similar investment strategies, making them, collectively, probably the biggest investor in listed Australian insurance companies. For industry funds and other investors the value of for-profit general insurers has nothing to do with the products they offer. Rather, the ability of insurers to

[63] Hostplus 2015, *Annual report,* pp. 70–71.

quickly convert increased premium revenue into an improved bottom line makes them attractive targets for superannuation funds pursuing healthy and reliable returns.

This feature of Australia's general insurance industry gives rise to a perversity of sorts; low-income Australian workers, disadvantaged through their inability to afford insurance coverage today, benefit somewhat in the long run if their superannuation entitlement grows as a consequence of insurance companies raising premiums in order to maintain investor returns.

Industry definitions and metrics

A peculiarity of Australia's general insurance industry is the inconsistent language used to describe performance. The industry is not short of specialised terms, with more than 200 on the website of Australia's National Insurance Brokers Association (ANIBA). Beyond their reporting of key data to APRA, insurers have considerable freedom to use language that suits them. At times this takes the effect of nuance, an example being QBE and IAG adopting slightly different definitions of an 'expense ratio'.[64] At other times companies use terms capable of being interpreted differently. When Suncorp reported a profit forecast fall in late 2015 it drew heavily on a declining 'insurance trading ratio' although that term does not appear in the ANIBA or ICA glossaries. References to 'margin' can also have different meanings, and the expressions 'underlying margins', 'return on equity', 'insurer profitability as a share of premiums' and 'profit margin' all appear from time to time in performance commentary.

The use of different definitions has evolved because it suits insurers. While helpful to them it does not necessarily help governments seeking to analyse the industry's contribution to desired public policy outcomes.

The Australian dollar

Insurers are impacted when the value of the Australian dollar falls relative to major international currencies. This is particularly the case in relation to the purchase of reinsurance. As an example, the Australian dollar's value fell from around US$1.05 to US$0.70 in the five years between 2011 and 2016, representing a full third. If a significant depreciation coincides with the need to secure larger reinsurance coverage, the impact on the insurer, and ultimately customers, is even more pronounced.

Education, engagement and risk mitigation

As will be detailed later in this paper, private insurers operating in competitive markets are less well equipped to influence risk than monopoly state-owned insurers. A state-owned insurer charged with a public policy objective of risk reduction has the

[64] QBE's website definition of 'expense ratio' is 'Underwriting and administrative expenses as a percentage of net earned premium', while IAG defines the same term as 'underwriting expenses as a percentage of net premium revenue'.

considerable advantage of being able to collaborate with other state agencies to mitigate risk.

Since the 2011 Queensland floods, however, for-profit insurers became more focused on risk mitigation. Through a subsidiary, IAG initiated a building resilience project in North Queensland, aimed at both reducing future flood and storm impacts and increasing insurance affordability. Property owners are provided with an assessment that details risks arising from the building's construction, exposure to wind and rain, as well as other possible defects. The completed assessment allows the insurer to advise the home owner of the potential premium reduction should remedial works be undertaken.

Similarly, NRMA has embarked upon public education as a means of reducing future claims:

> NRMA Insurance has piloted flood awareness seminars in partnership with local governments, the Floodplain Management Association and the NSW State Emergency Service. The seminars included information on disaster preparedness and recovery, insurance cover and floodplain management. They aimed to encourage consumers to take steps to manage their personal risk.[65]

These measures are welcome but they stand as exceptions within the insurance sector. The Financial Rights Legal Centre maintains that, in respect of building insurance:

> … current premium pricing and competition does not provide any benefits for consumers to take any personal mitigation strategies', and that there is no independent dispute mechanism policyholders can access when insurers decline to decrease premiums in response to mitigation work.[66]

For the commercial reasons outlined earlier it will always be difficult for even proactive for-profit insurers to justify the long-term investment of resources in activities that cannot be guaranteed to deliver a positive financial result for the company. This is particularly the case when a listed insurer needs to mollify stakeholders concerned that rising claims demand a cost-cutting response.

Notwithstanding the historical reluctance of for-profit insurers to invest in consumer engagement as a pathway to risk mitigation, engagement respects a desire of consumers to actively explore ways in which their assets can be better protected. A decade ago Scottish housing associations undertook an assessment of tenant attitudes to contents insurance and identified that a key to improving take-up rates was allowing tenants to help design the scheme. This helped increase trust in the product that was offered, addressing a key reason why some tenants had earlier refused to purchase

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[65] Productivity Commission 2014, *Policy reforms to improve natural disaster risk management*, p. 191.
[66] ibid., p. 220.

policies even though premiums had been reduced.[67] When consumers can be engaged in developing the product that will ultimately be offered to them it is likely they will be more inclined to purchase the product.

Efficacy and efficiency

If insurance coverage is to be increased among low-income Australians who have indicated to researchers their concern about affordability, providers need to be prepared to prioritise these concerns ahead of the need to maintain profit margins. This raises a valid question of efficacy. How can a public policy objective of expanded insurance coverage be achieved if it is dependent on for-profit providers with business models that eschew this behaviour?

The question invites a longer discussion about the ability of for-profit entities to deliver good public policy outcomes, which is beyond the remit of this paper. But other efficacy concerns are relevant at this point, including the ability of competing insurers to collectively impact on underlying risk.

Victoria's single CTP insurer is a helpful pointer to less obvious features of the monopoly provider model which assists the TAC in achieving its public policy objectives. A key feature of the TAC is its legislated objectives, which shape the educative and policy roles of the organisation. Section 11 of the *Transport Accident Act* obliges the Commission to 'ensure that the transport accident scheme emphasises accident prevention and effective rehabilitation'. Likewise the functions of the Commission include 'promot[ing] the prevention of transport accidents and safety in the use of transport'.

The TAC uses claims data to inform it and the government of justified remedial treatments on the road network, as well as educational programs and strategies that tackle the causes of accidents. Commission television advertisements that commenced in 1989 have contributed to a more than halving of the annual Victorian road toll. The campaign is one example of the way claims experience flows directly into risk mitigation, something that private insurers working in a competitive market are both reluctant and unable to do. While they stand to benefit from actions which reduce the risk of claims and the costs associated with ongoing claims management, private insurers would only fund such activity where it supports their profit objective and does not threaten the company's intellectual property in the form of its claims data. Insurers are sensitive on this point, particularly where competitors are able to persuade customers to switch.

A further impediment exists for private insurers. Unlike state governments, private insurers are usually powerless to enact remedial works that address the underlying risk. If the TAC, on the advice of police, determines that a particular road intersection redesign would reduce traffic accidents it is in a position to influence and in some instances directly fund the physical works. Additionally, it can fund educational

[67] Scottish Executive Social Research 2007, *Exploring the take-up of home contents insurance*, prepared by P Vestri of Hexagon Research and Consulting, p. 27.

programs, including television advertisements, and road signage warning drivers of dangerous intersections. Contrast these opportunities with an insurer trying to reduce risks associated with a property adjoining heavily timbered bushland. The insurer is powerless to influence works carried out within the bushland that might reduce the likelihood of fire. At the same time the insurer cannot force a householder to remove leaf litter on the insured property; at best it can only persuade, withdraw or threaten to withdraw insurance in the hope it triggers mitigating action.

In highlighting the weakness of for-profit insurers to mitigate risk as effectively as a monopoly state-owned insurer it is worth considering the latter's ability to better control its retail price. In part this is because governments, as sole shareholders, have both a greater capacity to withstand the fluctuating fortunes of insurance returns and a vested interest in reducing retail price volatility. The contrast between NSW and Victorian CTP annual price increases is illuminating. Following the NSW scheme's 1991 privatisation, Greenslip prices fell significantly: within two years motorists had seen the average premium fall from around $350 to $200. But relief was short-lived. By 1996 the price had climbed back above $350. Aggressive competition achieved the promised downward pressure on prices over the next decade but from 2006 premiums began rising by far more than CPI, reaching an average of $542 in 2015.

By comparison, the Victorian scheme's price increases have been far more consistent. Between 2000 and 2014, for example, the annual increase averaged 3.24 per cent, a result of the Commission's legislated obligation to limit premium increases to the consumer price index.[68] The constraint on year-to-year increases has resulted in the average Victorian CTP premium being around 45 per cent cheaper than the average NSW premium.

[68] See section 110 of the *Transport Accident Act*.

5 Recent initiatives and next steps

In spite of the challenges confronting for-profit insurers in Australia it is important to acknowledge recent efforts by individual companies to tackle the problem of non-insurance among low-income Australians. In 2014 Suncorp and GSM announced a partnership under the brand of *Good Insurance*, aimed at enabling 'many people on low incomes to access tailored insurance products at an affordable price'.[69] The product offers multiple forms including a basic contents cover of up to $10,000, a 'Contents Plus' cover of up to $20,000, and two variations of car insurance.

In 2015 GSM announced a partnership with IAG to offer a new contents product, *Insurance 4 That,* designed to provide customers with the option of insuring a single item. The initiative was aimed at individuals who are less likely to insure including students, young professionals, first-time renters, retirees, pensioners and the budget-conscious.

The initiatives demonstrate a willingness of two of Australia's largest listed for-profit insurers to tackle a longstanding problem. Both have focused on affordability, a critical concern for many low-income Australians and have made efforts to simplify the products in response to consumer concerns about complexity. It remains to be seen whether IAG and Suncorp can maintain their commitment to the products through inevitable future fluctuations in profitability. In view of the propensity of insurers to raise premiums following high claim periods this shapes as a critical test.

BSL believes that, notwithstanding the commitments made by IAG and Suncorp, their new products are susceptible to price increases as the insurance industry's claims cycle inevitably turns upwards. For this reason, a separate NFP insurance platform is worthy of deeper consideration.

Not-for-profit insurance

Freed of the requirement to return shareholder dividends, NFP insurance should be able to deliver products at a lower price than a for-profit entity, particularly if reinsurance does not feature as an input cost.

BSL believes that a NFP insurance approach could be useful in tackling two significant insurance coverage shortfalls in Australia today. The first of these, contents insurance, has been referenced throughout this paper. While building insurance is regularly cited in discussions about the role and value of insurance, contents insurance is a protection that most low-income Australians can more easily relate to as it is not dependent on home ownership. Furthermore, the risk of damage to contents is in some respects less than with buildings: residents leaving their home ahead of cyclones and fires often have the opportunity to take with them at least some valued possessions. Similarly,

[69] GSM and Suncorp media release, 12 June 2014.

floodwater that might damage the lower levels of a home won't necessarily damage possessions stored at a higher level in secure waterproof containers.

Insurance with rent schemes are well established in the United Kingdom and appear to offer a workable model for Australia. By offering standard contents policies at fixed prices various housing authorities have been able to secure coverage at a remarkably affordable price; in 2005 numerous Scottish housing authorities were able to offer up to £10,000 cover for less than one pound per week.[70] A key advantage of the Scottish model is the supporting role played by housing authorities, which include premiums as part of the rental payment where tenants choose to accept the coverage. This involvement reduces collection costs.

A second opportunity for NFP insurance exists in respect of third party property insurance for motor vehicles. Unlike the compulsory personal injury charge imposed on every Australian motorist through state and territory legislation, no jurisdiction mandates insurance coverage against property damage to other parties arising from the 'at fault' actions of the motorist. Between 10 and 15 per cent of Australian motorists have no such insurance coverage, with many low-income motorists experiencing significant financial loss when sued. Bankruptcies are not uncommon and debts, when on-sold by insurers to debt collection firms, can remain a threat to the financial wellbeing of the uninsured party well into the future.

Over the past 30 years state governments have considered but rejected mandated third party property insurance solutions. Notwithstanding the recent initiatives by Suncorp and IAG, general insurers have been slow to develop low-priced products that would build up coverage rates.

In 2016–17 BSL will explore how NFP insurance might be used to overcome contents and motor vehicle insurance coverage shortfalls for the benefit low-income Australians. As well as seeking to capitalise on the lower costs that a NFP platform offers, BSL will identify low-cost distribution channels and partnerships with external agencies that can actively mitigate the risks.

[70] Scottish Executive Social Research, op. cit., p. 34.

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Acronyms and abbreviations

ABS	Australian Bureau of Statistics
APRA	Australian Prudential Regulatory Authority
ASIC	Australian Securities and Investments Commission
BSL	Brotherhood of St Laurence
CTP	Compulsory third party
FSI	Financial System Inquiry
GSM	Good Shepherd Microfinance
IAG	Insurance Australia Group (insurer)
ICA	Insurance Council of Australia
MAA	Motor Accident Authority (NSW)
NILS	No Interest Loans Service
NRMA	National Roads and Motorists Association (insurer)
FSLM	Fire Services Levy Monitor (Victoria)
RBA	Reserve Bank of Australia
SFHA	Scottish Federation of Housing Associations
TAC	Transport Accident Commission (Victoria)