

AUSTRALIAN PRUDENTIAL REGULATION AUTHORITY

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Senator Chris Ketter
Chair
Senate Economic References Committee
Parliament House
Canberra ACT 2600

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**APRA Submission to the Senate Economics References Committee Inquiry into
Australia's general insurance industry**

Dear Senator Ketter,

The Australian Prudential Regulation Authority (APRA) welcomes this opportunity to make a submission to the Senate Economics References Committee Inquiry into Australia's general insurance industry.

Financial regulation and APRA

APRA is one of four independent agencies that oversee the Australian financial system. It is responsible for prudential supervision of individual financial institutions (authorised deposit-taking institutions (banks, building societies and credit unions), life and general insurance and reinsurance companies, private health insurers, friendly societies and superannuation funds (excluding self-managed funds)) and for promoting financial system stability in Australia.

In undertaking its mandate, APRA is required to balance the objectives of financial safety and efficiency, competition, contestability and competitive neutrality, and, in balancing these objectives, to promote financial system stability in Australia.

The general insurance industry

There were 109 general insurers licensed to conducted business as of 30 September 2016. Across Australia, the top 10 licensed insurers wrote 75.4 per cent of total net earned premium for financial year ended in the 12 months to June 2016. This reflects a continuation in the industry's trend towards greater consolidation, largely driven by heightened price competition and low interest rates.

In the year ended 30 September 2016 compared to year ended 30 September 2015, growth in premium income remained relatively flat in the home and motor classes of business. Gross earned premiums increased by 4.4 per cent in the motor class, and 2.9 per cent in the home class for the same period. The home class of business has seen an improvement in underwriting profitability from reduced catastrophe claims, while underwriting profitability remained unchanged in the motor class.

APRA does not have any immediate prudential concerns with the personal lines insurance market. In the commercial space, competitive pressures have been heightened and there are strong levels of capacity in the marketplace. APRA is closely monitoring these trends, and is assessing the robustness of the risk management and governance in place within insurers to manage the risk of under-pricing in this environment. Further information on the state of the general insurance industry can be found in APRA's 2015/16 Annual Report and APRA's general insurance statistical publications.¹

Competition and pricing

The personal lines market continues to display healthy competition. Incumbents have maintained a competitive position in all classes of business, while coming under increasing pressure from challenger brands such as Auto and General, Youi and Hollard, which continue to grow their market share. Large retail groups are also continuing to have an impact, as they seek to gain market share, particularly in the domestic motor class of business.²

Price comparison platforms that are focused on this class continue to maintain only a small presence in the market.³ From a prudential perspective, aggregators can pose a risk of mispricing by uncovering and potentially exploiting any deficiencies in insurers' pricing models. Companies attempt to price risk to the best of their abilities, based on various metrics and internal models. These are rarely perfect and companies will tend to offer different prices for the same risks. This means that at any one time, an insurer will likely be under-pricing some risks and over-pricing others. Aggregators may exploit this weakness by having insurers attain a disproportionate share of business for which they have unintentionally mispriced. This can result in negative implications for insurer's profitability, putting potential strain on capital and adversely effecting policyholder interests.⁴

¹ APRA Annual Report 2015/16, <http://www.apra.gov.au/AboutAPRA/Publications/Pages/annualreport-2015-16.html>

Statistics Publication, *Quarterly General Insurance Performance Statistics*, <http://www.apra.gov.au/GI/Publications/Pages/quarterly-general-insurance-statistics.aspx>

² Insight Issue Three 2013, *General Insurance industry Overview* <http://www.apra.gov.au/Insight/Pages/Insight-Issue-Three-2013-HTML.aspx>

³ Ibid

⁴ APRA's Financial System Inquiry Response Paper, July 1014 <http://apra.gov.au/Submissions/Documents/140829-APRA-FSI-Response.pdf>

An over-emphasis on price can also generate increased frequency of customer switching, further driving up an insurer's administrative costs. Price of insurance is important, but it should not be the sole component driving decision making for consumers. The value of an insurance policy should also consider the key benefits and conditions of the product (such as coverage, limits on amount of cover, exclusions, excesses and service levels).

Aggregators may aid comparison based on price, but do not tend to take into account these key benefits and conditions. As aggregators may decrease the transparency of important differences between products and policies, comparator sites should attempt to strike a balance between allowing consumers to easily compare products based on price, while maintaining awareness of key policy terms and conditions.

When aggregators place an exaggerated emphasis on comparison of price, consumers may not adequately consider the differences in terms and conditions of the policies. A 2014 study by the United Kingdom Financial Conduct Authority found that, in that market, aggregators had not taken appropriate steps to provide consumers with the necessary information to make informed choices when purchasing general insurance products.⁵

Transparency and disclosure

APRA has taken steps to enhance transparency and disclosure in the general insurance industry, as transparency can support market discipline of insurers and thereby further APRA's prudential supervision mandate.

Improved prudential disclosure by insurers

APRA observed a range of public disclosure practices by insurers within Australia.⁶ In response, APRA has actively encouraged enhanced voluntary disclosure by entities, in particular with respect to disclosure of prudential matters concerning the entities themselves.⁷ Clear and comprehensive disclosure can significantly enhance market discipline and create strong incentives for insurers to conduct their business in a safe, sound, fair, prudent and efficient manner.

Publication of statistical data by APRA

APRA acts as a national statistical agency for the Australian financial sector. It collects and publishes data from prudentially regulated and other financial institutions to support its primary mission, as well as to provide support to other public sector agencies.

⁵ Financial Conduct Authority 2014, *Thematic Review TR14/11 - Price comparison websites in the general insurance sector*, July. <https://www.fca.org.uk/publication/thematic-reviews/tr14-11.pdf>

⁶ APRA letter to CEOs of GI and Level 2 groups and life companies, *Public disclosure for prudential purposes for insurers*, 22 June 2015, <http://www.apra.gov.au/CrossIndustry/Pages/Public-disclosure-for-prudential-purposes-for-insurers-June-2015.aspx>

⁷ Letter to CEOs of general insurers and life companies, *Public disclosure for prudential purposes for insurers*, June 2015, <http://www.apra.gov.au/lifs/Pages/Letter-to-CEOs-of-general-insurers-and-life-companies-Public-disclosure-for-prudential-purposes-for-insurers.aspx>

For its part, APRA remains committed to modernising its data dissemination capabilities to facilitate effective public access to all non-confidential data. In 2016, APRA consulted on a proposal to expand its publication of industry-level general insurance statistics and institution-level statistics. The revised statistical publications now include additional non-confidential industry data, in line with the Government's Public Data Policy to extend the value of public data to the benefit of the Australian public.

APRA would be happy to discuss the contents of this letter in more detail. For any questions please contact Peter Kohlhagen () or ().

Yours sincerely

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APRA Member