

Chapter 2

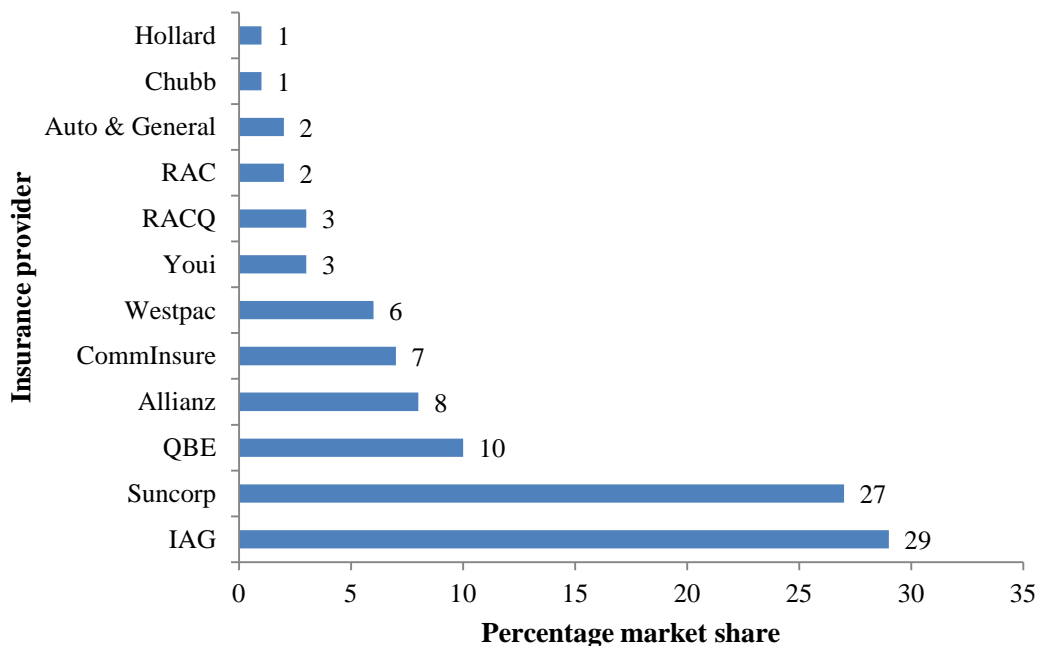
The general insurance industry in Australia

Overview

2.1 Australia has a large and long-established general insurance industry. As at 30 September 2016, there were 109 Australian Prudential Regulation Authority (APRA) registered general insurers licensed to conduct business in Australia. Of these, 99 were direct insurers and 10 were reinsurers.¹

2.2 The home and motor insurance market in Australia is dominated by four main insurers—IAG, Suncorp, QBE and Allianz—issuing cover under multiple brands.² Collectively, these larger insurers make up approximately 74 per cent of the market.³ Smaller and newer market entrants include Youi, Auto & General, and Hollard. Figure 2.1 details the market share of the top 12 general insurers for home insurance in Australia.

Figure 2.1—Market share of top 12 general insurers for home insurance⁴



1 Australian Prudential Regulation Authority, *Submission 7*, p. 1.

2 See IBISWorld, *IBISWorld Industry Report K6322: General Insurance in Australia*, November 2016, pp. 23–26.

3 Australian Prudential Regulation Authority, answers to questions on notice, 12 April 2017 (received 5 May 2017).

4 Australian Prudential Regulation Authority, answers to questions on notice, 12 April 2017 (received 5 May 2017).

2.3 The number of licenced insurers has fallen in recent years, with a net decline of 25 over the past decade.⁵ This trend toward greater market concentration was noted by APRA, the prudential regulator of the financial services sector, in its latest annual report:

The steady decline in recent years is largely the result of rationalisation within some insurance groups that had held multiple licences arising from past mergers and acquisitions. As a result, the industry has become more concentrated, with the five largest insurers accounting for 54 per cent of total gross written premium (GWP). A decade earlier, the five largest insurers wrote only 42 per cent of GWP.⁶

2.4 In the 12 months to 30 September 2016, GWP⁷ for home insurance was \$7882 million, with an average premium of \$668, and GWP for motor insurance was \$8625 million, with an average premium of \$566.⁸

2.5 Over the same period, total industry net profit⁹ after tax was \$3.1 billion, up from \$2.4 billion the previous year and representing a return of 11.2 per cent on net assets.¹⁰ However, as noted by the Insurance Council of Australia (ICA), while net profit increased by \$0.7 billion in the year to 30 September 2016, it is down around 25 per cent from the 13 year average (September 2003–September 2016) of \$4.1 billion.¹¹

Regulatory framework

2.6 Australian Government bodies are responsible for some aspects of regulation of the general insurance industry, such as consumer protection and licencing; however, the operation of the industry is self-regulated and operates under a voluntary code.

Government bodies

Australian Securities and Investments Commission

2.7 The Australian Securities and Investments Commission (ASIC) is the government body with primary responsibility for regulation of insurers. ASIC has oversight of consumer protection matters and licencing for the financial services sector, and by extension, internal and external dispute resolution. ASIC's regulatory

5 Australian Prudential Regulation Authority, *Annual Report 2015–16*, p. 24.

6 Australian Prudential Regulation Authority, *Annual Report 2015–16*, p. 24.

7 Gross written premium (GWP) is the total premium on insurance underwritten by an insurer or reinsurer during a specified period, before deduction of reinsurance premium.

8 National Insurance Brokers Association, *Submission 2*, p. 6.

9 Net profit after tax refers to profit from ordinary activities after income tax, before extraordinary items are taken into account.

10 Australian Prudential Regulation Authority, *Quarterly General Insurance Performance Statistics*, September 2016, p. 5.

11 Insurance Council of Australia, *Submission 13*, p. 13.

powers pertaining to the general insurance industry are carried out in accordance with two laws, the *Corporations Act 2001* (Corporations Act), and the *Australian Securities and Investments Act 2001* (ASIC Act).

2.8 The Corporations Act¹² provides for a licencing system for financial services providers, including insurance companies. General insurance products are considered financial products under the Corporations Act; and therefore, insurers are required to be licensed by ASIC in order to provide financial services.

2.9 The Corporations Act and *Insurance Contracts Act 1984* (Insurance Contracts Act) set out the current product disclosure regime for general insurance products (discussed in detail in chapter 3), under which insurers must comply with a number of mandatory disclosure requirements.

2.10 The ASIC Act also contains ASIC's consumer protection powers in relation to financial products and services, including general insurance. Under the ASIC Act, general insurers are prohibited from partaking in misleading or deceptive conduct, unconscionable conduct, and from providing false or misleading representations.

2.11 Of considerable importance to this inquiry is the current exemption of insurance contracts from the unfair contract terms (UCT) provisions under the ASIC Act. The UCT provisions apply to all other standard form contracts¹³ in the financial services sector. The exemption of insurance from the UCT regime is discussed further in chapter 5.

Australian Prudential Regulation Authority

2.12 Insurers must adhere to capital adequacy laws. Mr Geoff Summerhayes, Executive Board Member at APRA, told the committee that APRA is 'primarily concerned with the institutions' viability and ability to meet the promises they make to beneficiaries'.¹⁴ APRA supervises general insurers under the *Insurance Act 1973* (Insurance Act).

2.13 APRA's responsibilities under the Insurance Act include:

- authorising companies to carry on a general insurance business; and
- monitoring authorised general insurers to ensure their continuing compliance with the Insurance Act, in particular, its minimum solvency requirements.¹⁵

12 Licencing and product disclosure requirements pertaining to general insurance providers and products are contained in Chapter 7 of the Corporations Act. These provisions were first introduced through the *Financial Services Reform Act 2001* with the broad objective of consolidating regulation of the financial services sector.

13 A standard form contract is one that has been prepared by one party to the contract and is not subject to negotiation between the parties.

14 *Proof Committee Hansard*, 12 April 2017, p. 62.

15 Australian Securities and Investments Commission, *Submission 22*, p. 8.

Australian Competition and Consumer Commission

2.14 In accordance with the *Competition and Consumer Act 2010*, the Australian Competition and Consumer Commission (ACCC) is responsible for the investigation and enforcement of prohibitions on certain anticompetitive conduct. However, the ACCC's role in relation to insurance is limited and, as noted above, ASIC has primary responsibility for regulation of insurers.

Insurance Contracts Act 1984

2.15 Insurers must comply with general contract law and the Insurance Contracts Act, which regulates the content and operation of insurance contracts.

2.16 Section 13 of the Insurance Contracts Act places a statutory obligation on both an insurer and the insured¹⁶ to comply with a 'duty of utmost good faith'. Specifically:

A contract of insurance is a contract based on the utmost good faith and there is implied in such a contract a provision requiring each party to it to act towards the other party, in respect of any matter arising under or in relation to it, with the utmost good faith.¹⁷

2.17 In other words, the duty requires both parties to act honestly with each other throughout the duration of the policy and voluntarily disclose any information which would be considered material to contract negotiations.

2.18 The purpose of the Insurance Contracts Act is to:

...improve the flow of information from the insurer to the insured so that the insured can make an informed choice as to the contract of insurance he enters into and is fully aware of the terms and limitations of the policy; and to provide a uniform and fair set of rules to govern the relationship between the insurer and insured.¹⁸

2.19 Of particular relevance to the inquiry, Part 5 of the Insurance Contracts Act provides for a number of prescribed classes of insurance contracts. The operation of prescribed contracts is clarified in the Insurance Contracts Regulations 1985. These regulations set out the minimum requirements for a policy to provide 'standard cover'. However, under Section 35(2) of the Insurance Contracts Act, insurers can provide policies that deviate from standard cover if the insurer 'clearly informs' the insured of this fact.

2.20 In 2012, the Parliament passed legislation amending the Insurance Contracts Act to enable regulations to be made requiring insurers to provide a one-page Key Facts Sheet (KFS) for home building and contents insurance policies. The Insurance Contracts Regulation 2012 (No. 2) prescribes the content, format and information that

16 A person or entity who buys insurance is known as an insured or policyholder.

17 *Insurance Contracts Act 1984*, ss. 13(1).

18 Senator Gareth Evans, Attorney-General, *Senate Hansard*, 1 December 1983, p. 3136.

must be included in a KFS. The effectiveness of the KFS with regard to improving consumer outcomes is discussed in detail in chapter 3.

Insurance Council of Australia

2.21 Established in 1975, Insurance Council of Australia (ICA) represents the interests of the Australian general insurance industry and is the peak representative body for general insurance companies licenced under the Insurance Act.

General Insurance Code of Practice

2.22 The General Insurance Code of Practice (the Code) is a voluntary self-regulatory industry code developed by the ICA. First introduced in 1994, the Code covers most classes of general insurance, including home, strata and motor insurance. The current version of the Code came into effect on 1 July 2014 and has been adopted by 49 companies in the industry.

2.23 The Code sets out the standards that general insurers must meet when providing services to their customers. For example, the Code requires that:

Our sales process and the services of our Employees and our Authorised Representatives will be conducted in an efficient, honest, fair and transparent manner.¹⁹

2.24 The Code is monitored and enforced by the Financial Ombudsman Service (FOS), an accredited dispute resolution provider under ASIC's requirements.²⁰

2.25 On 17 February 2017, the ICA announced that it will be undertaking a limited industry review of the Code. The review has been prompted in response to recent developments in the general insurance industry, including this inquiry. The ICA will carry out the review in consultation with key stakeholders including ASIC and FOS.²¹

Insurance comparison services

2.26 Issues of clarity, transparency and ease of comparability among general insurance products have been a consistent focus of this inquiry. Consumers' ability, particularly in complex transactions like insurance, to understand and make appropriate choices is often hindered by the lack of sufficient understanding or information to compare different insurance products.

2.27 An insurance comparison service, often referred to as an aggregator or price comparison website (PCW), is generally an online platform that acts as an intermediary between insurers and consumers searching for a range of insurance products. Consumers are generally required to provide certain personal details online

19 Insurance Council of Australia, *General Insurance Code of Practice*, <http://codeofpractice.com.au/document> (accessed 29 May 2017).

20 The Financial Ombudsman Service is approved to operate as an external dispute resolution scheme under ASIC's Regulatory Guide 139 (RG 139).

21 Insurance Council of Australia, Media Release, *Insurance Council kicks off fresh review of industry Code of Practice*, February 2017, p.1.

before being presented with information on a number of insurance products to compare.²²

2.28 There are a number of private and independent (government-run) comparison services operating in Australia and overseas jurisdictions, including the United Kingdom, Norway, Ireland, and the United States. Australian examples include the North Queensland home insurance (NQHI) comparison website, administered by ASIC; privatehealth.gov.au, administered by the Private Health Insurance Ombudsman; and commercial comparison websites such as iSelect and Compare the Market. The merits and efficacy of these comparison services are discussed in greater detail in chapter 4.

Regulator guidance for comparison websites

ASIC Regulatory Guide 234

2.29 In 2012, ASIC issued its Regulatory Guide 234, *Advertising financial products and services (including credit): Good practice guidance* (RG 234). RG 234 'contains good practice guidance to help promoters of financial services comply with their legal obligations to ensure they do not make false or misleading statements or engage in misleading or deceptive conduct'.²³ It includes guidance relating to the promotion and provision of financial products through comparison websites, and specifies that promoters should disclose:

- a) the basis of any ratings or awards attributed;
- b) any links to providers of the products that are being compared, including commissions, referral fees, payments for inclusion in comparisons and/or payments for 'featured' products;
- c) a warning if not all providers are included in the comparison;
- d) that any advertisements included on the website are presented as advertisements, to prevent consumers being misled about the ranking of a product; and
- e) a warning that products compared do not compare all features that may be relevant to the consumer.²⁴

ACCC guide for comparison website operators and suppliers

2.30 Following a review of Australia's comparator website industry in 2014, the ACCC released a guide for comparison website operators and suppliers. As well as encouraging compliance with the *Competition and Consumer Act 2010*, the guidance is intended to assist operators and suppliers when making decisions about all aspects of comparator services, including in advertising and marketing. Moreover, in recognising the growing role of online markets to the Australian economy, the guide

22 Insurance Council of Australia, *Submission 13*, p. 25.

23 Australian Securities and Investments Commission, *Submission 22*, p. 9.

24 Australian Securities and Investments Commission, *Submission 22*, p. 9.

aims to promote positive consumer experiences and fair trading in the online sector.²⁵ But this guide is voluntary, and does not prescribe what information comparison websites must provide or the rules by which they must abide.

Increases in general insurance premiums

2.31 As part of its terms of reference, the committee was asked to examine the increase in the cost of home, strata and car insurance cover over the past decade in comparison to wage growth over the same period.

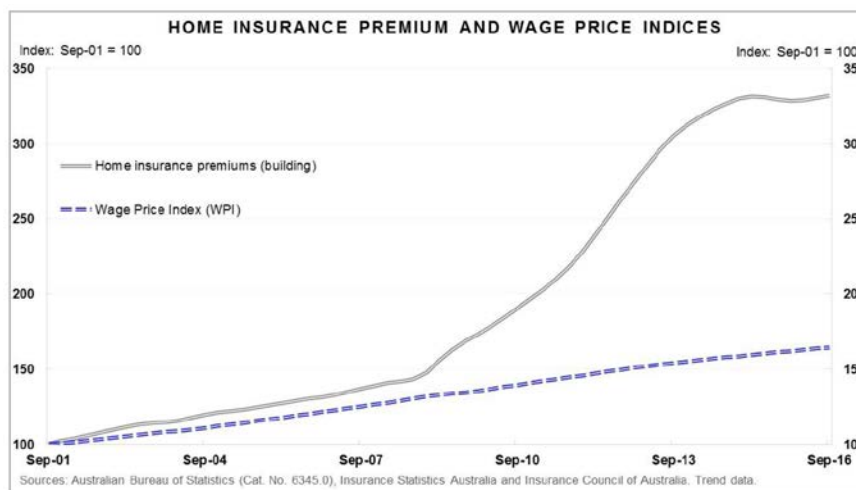
Home and motor insurance premium trends

2.32 In the 15 years to 2016, home insurance premiums in Australia have increased at an average annual rate of approximately 8.3 per cent. Over the same period, Australia's Wage Price Index (WPI) has increased at an average annual rate of approximately 3.4 per cent.²⁶ In contrast, growth in motor insurance premiums has been significantly slower, increasing at an average annual rate of approximately 1.7 per cent.²⁷

2.33 Since the beginning of 2014, home insurance premiums have experienced notably subdued growth and motor insurance premiums have experienced no growth.²⁸

2.34 Figures 2.2 and 2.3 illustrate these increases in home building and comprehensive motor insurance premiums relative to the WPI respectively.

Figure 2.2—Home insurance premiums and wage price indices²⁹



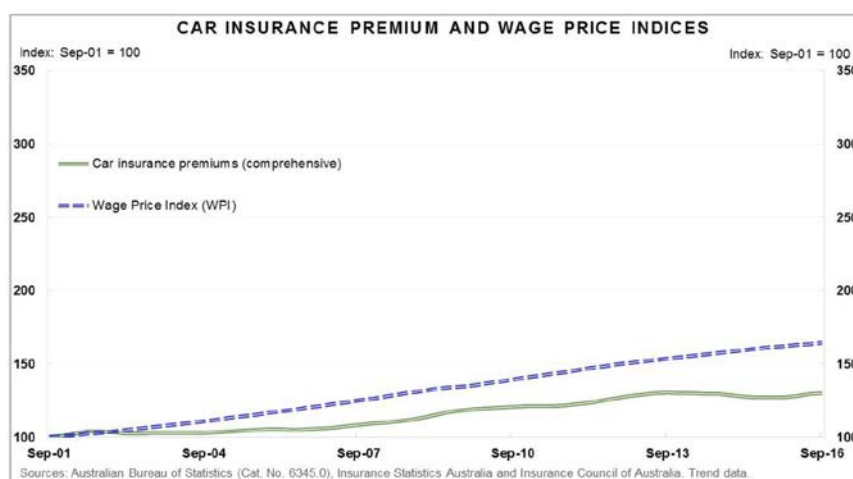
25 Australian Competition and Consumer Commission, *Comparison websites: A guide for comparison website operators and suppliers*, August 2015, p. 2. Accessed at: <https://www.accc.gov.au/publications/comparator-websites-a-guide-for-comparator-website-operators-and-suppliers>

26 Insurance Council of Australia, *Submission 13*, p. 8.

27 Insurance Council of Australia, *Submission 13*, p. 10.

28 Insurance Council of Australia, *Submission 13*, pp. 8, 10.

29 Insurance Council of Australia, *Submission 13*, p. 8.

Figure 2.3—Car insurance premiums and wage price indices³⁰

Strata insurance premium trends

2.35 In 2013, the government commissioned the Australian Government Actuary to conduct a study into strata insurance pricing in North Queensland. In undertaking this study, the Australian Government Actuary was asked to compare strata insurance pricing across Northern Australia and other east coast centres.³¹

2.36 The Australian Government Actuary's report showed that, between 2006 and 2013, strata premiums for Australia's east coast centres increased at a similar rate relative to Australia's WPI,³² which grew by approximately 28 per cent.³³ In contrast, strata insurance premiums in North Queensland increased at a significantly faster rate, more than tripling the rate of increase in other centres over the same period (figure 2.4).³⁴

30 Insurance Council of Australia, *Submission 13*, p. 10.

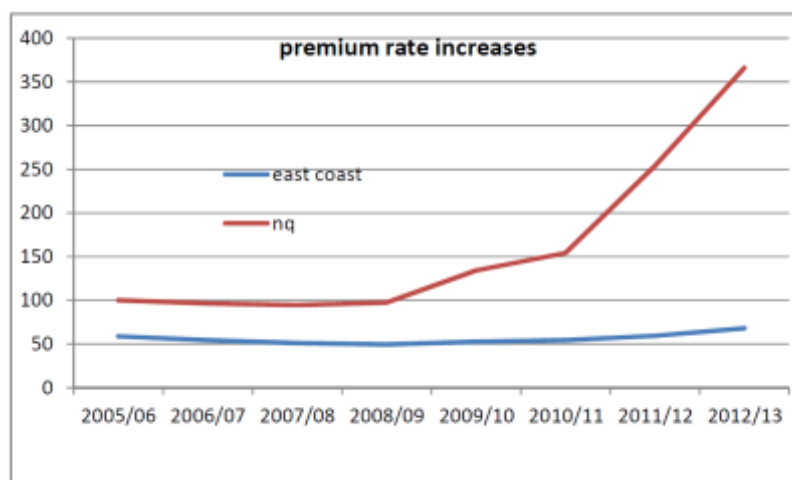
31 Australian Government Actuary, *Second Report on Strata Title Insurance Price Rises in North Queensland*, June 2014, p. 3.

32 Australian Government Actuary, *Second Report on Strata Title Insurance Price Rises in North Queensland*, June 2014, p. 19.

33 See Australian Bureau of Statistics, *Cat No. 6345.0—Wage Price Index, Australia*.

34 Australian Government Actuary, *Second Report on Strata Title Insurance Price Rises in North Queensland*, June 2014, p. 19.

Figure 2.4—Strata premiums in North Queensland and east coast centres³⁵



Reasons for insurance premium increases

2.37 The main driver for increased premiums in home, strata and car insurance in recent years has been growth in claims costs.³⁶ However, there are a wide range of other complex and inter-related factors that have contributed to increases in these classes of insurance. Some of these factors have had a direct and significant impact on premium increases, while others have had smaller, more indirect impacts. Moreover, the risk-based nature of general insurance means that some factors have affected certain consumers more than others, such as those living in regions that face greater natural perils.³⁷

2.38 Rising premiums in home insurance, particularly in regions such as North Queensland, have been driven by sharp increases in claims volumes, higher claim amounts, and substantial increases in the costs associated with meeting those claims (e.g. repairing and rebuilding costs). These factors have largely resulted from a high number of major weather and natural catastrophe events over the past decade, including cyclones, storms, floods and bushfires.³⁸ Insurers have revised their natural peril data following these events to more appropriately reflect the risk faced in regions where such events are more frequent, severe and costly.³⁹

2.39 The growth in strata insurance premiums has been largely driven by the same factors affecting home insurance. However, rises in this class of insurance have also been affected by the location and concentration of strata properties, with extensive

35 Australian Government Actuary, *Second Report on Strata Title Insurance Price Rises in North Queensland*, June 2014, p. 19.

36 QBE, *Submission 16*, p. 5.

37 Financial Rights Legal Centre, *Submission 9*, p. 4.

38 Insurance Council of Australia, *Submission 13*, pp. 7–8. See also QBE, *Submission 16*, p. 5.

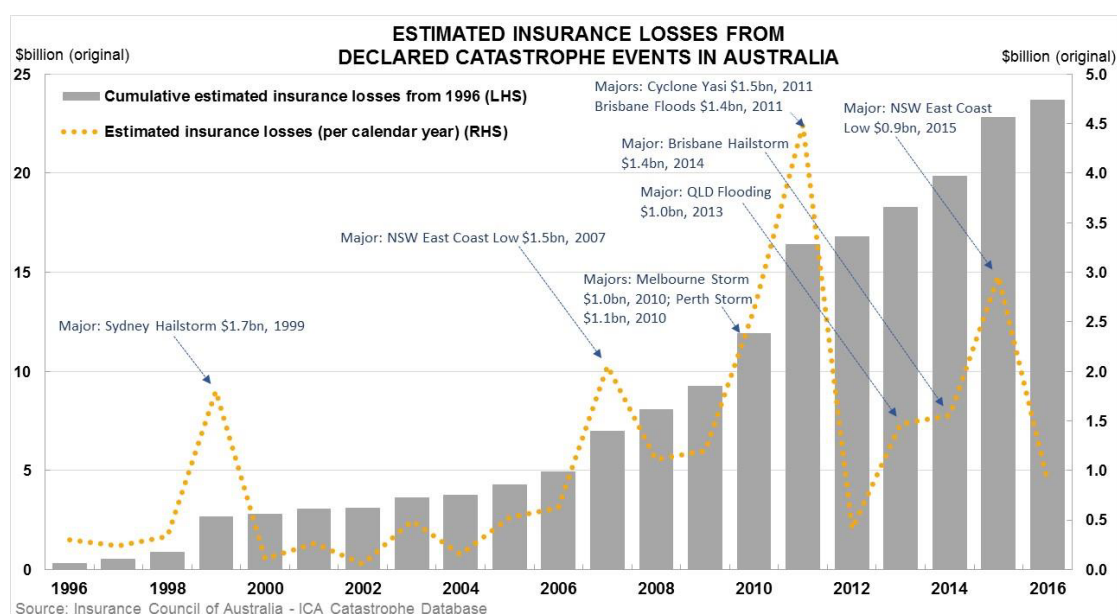
39 QBE, *Submission 16*, p. 5.

strata development along Australia's east coast, particularly in cyclone-prone regions, in recent years.⁴⁰

2.40 With regard to strata insurance in North Queensland, the Australian Government Actuary found that premium increases in that region were a result of numerous factors, such as historical under-pricing, increases in the cost of reinsurance and losses caused by a number of natural disasters.⁴¹

2.41 According to the ICA, insurance losses resulting from declared catastrophe events over the past two decades total approximately \$24 billion.⁴² Moreover, QBE analysis estimates that between 2000 and 2012 alone, the losses borne by insurers from natural disasters totalled \$16.1 billion, an average of over \$1.2 billion per year.⁴³ Figure 2.5 illustrates the estimated insurance losses from declared catastrophe events in Australia over the past two decades.

Figure 2.5—Estimated insurance losses from declared catastrophe events in Australia (1996–2016)⁴⁴



40 IAG, *Submission 15*, p. 18.

41 Australian Government Actuary, *Second Report on Strata Title Insurance Price Rises in North Queensland*, June 2014, p. 3.

42 Insurance Council of Australia, *Submission 13*, p. 4.

43 QBE, *Submission 16*, p. 5.

44 Insurance Council of Australia, *Submission 13*, p. 4.

2.42 Factors that should be considered when examining increasing general insurance premiums include:

- the increased cost of reinsurance;
- the introduction of automatic flood cover;
- improved flood information data;
- the increasing cost of construction, rebuilding and repairs;
- the use of some modern construction methods and materials;
- the tightening of building regulations, codes and standards;
- the growth of the housing market;
- a lack of competition in some areas (e.g. Northern Australia);
- the increase in motor vehicle technology and complexity;
- increased use of granular data profiles; and
- standard inflationary pressures and general economic conditions.⁴⁵

Premiums and wage growth

2.43 A number of submitters questioned the validity of comparing increases in premiums for home, strata and car insurance with wage growth, emphasising that changes in these measures are driven by different and largely uncorrelated factors.⁴⁶

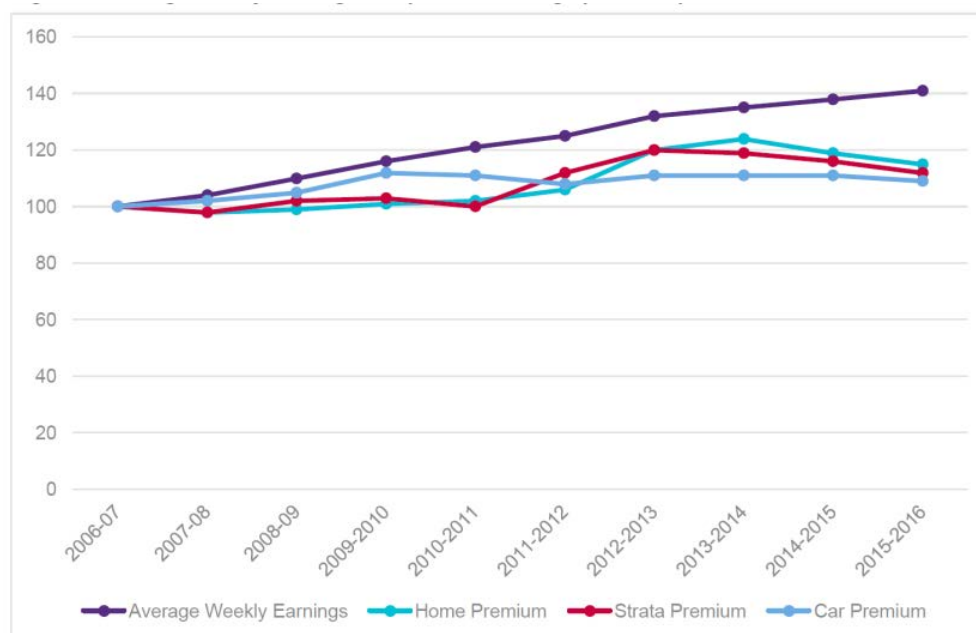
2.44 In its submission, IAG argued that 'the cost of a home insurance premium must be viewed in the economic context that the value of the asset has increased over the past decade'. IAG further argued that 'a more accurate indication of the movement of insurance premiums in comparison to earnings over time takes into account the sum insured of the asset being covered' (figure 2.6).⁴⁷

45 See Financial Rights Legal Centre, *Submission 9*, pp. 3–4.

46 National Insurance Brokers Association, *Submission 2*, p. 2; Insurance Council of Australia, *Submission 13*, p. 7; QBE, *Submission 16*, p. 5.

47 IAG, *Submission 15*, p. 16.

Figure 2.6—Average weekly earnings compared to average premium per \$1000 sum insured⁴⁸



Committee view

2.45 The committee acknowledges that premium increases and wage growth are influenced by a variety of internal and external factors. However, the committee also considers the rate of premium increases relative to wage growth, particularly for home and strata insurance, has important implications with regard to the financial pressure placed on Australian consumers and the proportion of income being spent on insurance.

2.46 The committee recognises that rises in insurance premiums observed in regions such as North Queensland have undoubtedly been influenced by the incidence of major weather and natural catastrophe events over the past decade. However, the committee is concerned that consumers are unable to determine if premium increases have been driven by this increased risk alone, or whether other factors, such as a lack of competition, have also contributed to the premium rises.

2.47 That said, the committee also notes that there have been several government and industry reviews relating to premium increases in home and strata insurance. These reviews have consistently found that, despite notable increases, premiums remain commensurate with the level of risk.⁴⁹ Given this, the committee does not propose to examine premium increases or their justification further in this report; however, it acknowledges the increased financial pressure that these increases can and

48 IAG, *Submission 15*, p. 16.

49 See, for example, Australian Government Actuary, *Second Report on Strata Title Insurance Price Rises in North Queensland*, June 2014; Australian Government Actuary, *Report on home and contents insurance prices in North Queensland*, December 2014; Northern Australia Insurance Premiums Taskforce, *Final Report*, November 2015.

has placed on many consumers. The role of disaster mitigation in reducing insurance premiums is discussed in chapter 5.

Competition in the general insurance industry

2.48 Competition is the cornerstone of well-functioning markets, driving efficiency with regard to price, innovation, service and product quality, and providing better information that allows for more informed consumer choices. To that end, competitive markets deliver positive consumer outcomes and, by extension, increase the welfare and prosperity of all Australians.

2.49 Healthy competition is integral to insurance affordability and accessibility. A lack of competition in insurance markets can result in negative consumer outcomes, such as premium increases, underinsurance, or coverage that is inappropriate to consumers' needs. These outcomes can have potentially devastating effects, not only on consumers' financial stability, but also on their mental and physical health. North Queensland provides some evidence of these negative effects. A lack of providers in this market, particularly for strata insurance, has resulted in barriers to many consumers acquiring cover.⁵⁰

Stakeholder views on competition

2.50 Industry stakeholders were of the consistent view that Australia's general insurance industry is highly competitive, contending that the large number of participants in the market and recent entry of challenger brands are evidence of this fact. For example, Mr Anthony Justice from IAG argued:

I think it is fair to say there is strong evidence that the market in Australia is highly competitive; there is a very large number of participants in the marketplace. We continue to see new entrants into the Australian market and we have seen several from overseas, particularly in recent years, who have built good market share positions. We feel the effect of that competition, we feel the effects of market share coming under pressure and we feel the effects of margins coming under pressure over time. So we would argue that there is very healthy competition in the Australian marketplace.⁵¹

2.51 The Australian Prudential Regulation Authority (APRA) shared this view, noting that:

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

50 See Mrs Margaret Shaw, *Submission 21*, p. 16.

51 Mr Anthony Justice, Chief Executive, Australian Consumer Division, IAG, *Proof Committee Hansard*, 12 April 2017, p. 39.

they seek to gain market share, particularly in the domestic motor class of business.⁵²

2.52 The National Insurance Brokers Association (NIBA) acknowledged that IAG and Suncorp have dominant positions in the general insurance market. However, NIBA also asserted that consumers 'have easy access to a number of alternative suppliers', with a range of smaller, challenger brands infiltrating the Australian market.⁵³

2.53 The ICA pointed out that the Financial System Inquiry (FSI) made a similar assessment of the level of competition in the general insurance industry.⁵⁴ Specifically, the FSI Interim Report observed that:

Although the sector has generally become more concentrated, some trends are moving in the opposite direction. For example, a number of new insurers have entered the market, including Youi, Hollard and Progressive. Banks and retailers have also entered the insurance market, usually white labelling products provided by the main insurers, but with some underwriting themselves.⁵⁵

Illusion of competition

2.54 Some inquiry participants queried the industry's assessment of the state of competition in the insurance market.

2.55 Mr John Rolfe argued that the general insurance market in Australia gives the 'illusion of competition, rather than genuine competition'. This is because, from a consumer perspective, there are a 'lots of different players to choose from. However, most of the major brands are ultimately controlled by just two companies: Suncorp and Insurance Australia Group'.⁵⁶

2.56 iSelect echoed this opinion, remarking that 'there can be a misrepresentation to the man on the street about pure competition'.⁵⁷ iSelect explained this view in its submission to the inquiry:

The significant concentration in the Australian market of the two major players—Suncorp and IAG—with around 70% market share [for motor insurance] between them, would appear to be substantially reducing competition in the general insurance market. This lack of true competition is masked from consumers as the major companies have maintained a plethora of brands retained after acquiring a number of smaller competitors.

52 Australian Prudential Regulation Authority, *Submission 7*, p. 2.

53 National Insurance Brokers Association, *Submission 2*, p. 7.

54 Insurance Council of Australia, *Submission 13*, pp. 16–17.

55 Financial System Inquiry, *Interim Report*, July 2014, p. (2)39.

56 Mr John Rolfe, *Submission 1*, [p. 3].

57 Mr David Christie, Chief Administrative Officer, iSelect, *Proof Committee Hansard*, 13 April 2017, p. 34.

These multiple brands give consumers the false impression that the marketplace is highly competitive.⁵⁸

North Queensland strata insurance

2.57 In her submission the inquiry, Mrs Margaret Shaw highlighted the apparent lack of competition in the strata insurance market in North Queensland and suggested that premiums have been affected as a result:

In 2012 North Queensland had only one insurer offering insurance for strata properties valued a replacement cost of \$5M and above—SUU—owned by CGU—owned by IAG. Premiums went haywire.⁵⁹

2.58 Mrs Shaw elaborated on this issue at a public hearing:

As to competition, in North Queensland, we are still experiencing difficulty in obtaining sensible quotes, especially for the strata properties of more than 10 units or those with a replacement value of greater than \$5 million. We quite often get stupid quotes such as \$20,000 for a house in Ingham. They do not earn \$20,000 in Ingham. There is also a large difference between quotes. For the 25 apartments where I live, quotes ranged from \$51,000 to over \$80,000. Companies which are considered major players, such as CHU, have not returned to the market, and some such as Zurich and Amp GI have left the strata market for good.⁶⁰

Industry profitability

2.59 During public hearings, the committee questioned stakeholders about the level of profitability in the industry and how this should be used to assess the state of competition in the general insurance market.

2.60 As noted earlier in this chapter, in the year to 30 September 2016, total industry net profit after tax was \$3.1 billion, up from \$2.4 billion the previous year and representing a return of 11.2 per cent on net assets.⁶¹ However, while net profit increased over the 12 month period, APRA data indicates that there has been deterioration in the financial performance of the general insurance industry over recent years.⁶²

2.61 Representatives from APRA noted that the agency is not observing 'excessive profits' in the industry at a portfolio level. Mr Geoff Summerhayes, Executive Board Member at APRA, further advised the committee:

As you would appreciate, we are not the competition regulator, so our primary lens is the prudential soundness of the institutions. That said, our mandate does require us to balance competition, contestability and

58 iSelect, *Submission 6*, p. 4.

59 Mrs Margaret Shaw, *Submission 21*, p. 16.

60 Mrs Margaret Shaw, *Proof Committee Hansard*, 13 April 2017, p. 12.

61 Australian Prudential Regulation Authority, *Quarterly General Insurance Performance Statistics*, September 2016, p. 5.

62 Insurance Council of Australia, *Submission 13*, pp. 13–14.

competitive neutrality, so it is a factor in our decisions. But, as we see the market, it is a well-functioning, healthy market which does not appear to be making excessive returns and is subject to a whole range of external influences that make profitability from one year to another quite variable.⁶³

2.62 Industry representatives emphasised the fact that profitability in the general insurance industry has experienced a downturn in recent years. For example, Mr Andrew Broughton from QBE commented:

As I think was stated by both our competitors before, insurance returns have actually been falling in recent years. We have a number of independent reports suggesting that returns in this sector, particularly in Australia, are adequate—certainly no more than that. They have actually deteriorated over recent years...We operate in a very tough market with broad macro-economic factors, such as low investment returns impacting our ability to return higher than what we would consider are adequate returns.⁶⁴

Competition in supply versus demand

2.63 In their submission, Professor Allan Fels and Professor David Cousins cautioned against making conclusions on the effectiveness of competition in the general insurance industry solely on the basis of supply factors, such as the number of providers or degree of market concentration. They reasoned that this kind of assessment 'fails to consider competition from the perspective of consumers'; that is, from a demand perspective.⁶⁵

2.64 Further elaborating on this point, Professors Fels and Cousins noted that:

From a consumer viewpoint, an important dimension of industry competition is the degree to which that competition is 'effective' in producing price and other outcomes (e.g. range of products and services, product innovation) that benefit consumers.⁶⁶

2.65 In giving evidence at a public hearing, Professor Fels argued that competition in the general insurance market 'is not fully effective', and that there is a clear weakness on the demand side of competition in the industry. This weakness is manifested in the low rates of consumer switching between insurers (consumer inertia), and the wide disparity that may be found between insurers in their quotations for identical properties and risks.⁶⁷ Professor Fels highlighted information asymmetry

63 *Proof Committee Hansard*, 12 April 2017, p. 64.

64 Mr Andrew Broughton, Executive General Manager, Corporate Partners and Direct, QBE Insurance Australia and New Zealand, *Proof Committee Hansard*, 12 April 2017, p. 52.

65 Professor Allan Fels AO and Professor David Cousins AM, *Submission 23*, p. 7.

66 Professor Allan Fels AO and Professor David Cousins AM, *Submission 23*, p. 7.

67 Professor Allan Fels AO, private capacity, *Proof Committee Hansard*, 13 April 2017, p. 1. See also, Professor Allan Fels AO and Professor David Cousins AM, *Submission 23*, pp. 4, 7.

between insurers and consumers, particularly with regard to how insurance is priced, as a primary barrier to effective competition from a demand perspective.⁶⁸

2.66 The concept of information asymmetry as it relates to insurance is discussed further in chapter 3.

Committee view

2.67 The committee notes that the government is yet to release its response to the final report of the Northern Australia Insurance Premiums Taskforce. The report was provided to the government in November 2015.

Recommendation 1

2.68 The committee recommends that the government release its response to the final report of the Northern Australia Insurance Premiums Taskforce.

2.69 The committee notes APRA's comments that the 'personal lines market continues to display healthy competition'. However, the committee also acknowledges the importance of examining the effectiveness of competition in the industry from a demand perspective. In this regard, the committee tends to agree with the view of Professors Fels and Cousins that competition in the general insurance market is not fully effective, and considers that consumers would benefit from increased competition.

2.70 With regard to strata insurance in North Queensland, the committee is highly concerned by evidence pointing to the difficulties experienced by consumers in obtaining quotes in this region. In light of the evidence received, the committee considers that a focused review into competition in the strata insurance market in North Queensland is warranted.

Recommendation 2

2.71 The committee recommends that the government conduct a review into competition in the strata insurance market in North Queensland to establish a fact base and explore avenues to improve insurer participation in this region.

68 Professor Allan Fels AO, private capacity, *Proof Committee Hansard*, 13 April 2017, p. 1.

