INSURANCE COUNCIL OF AUSTRALIA

Professor Allan Fels AO, Monitor
Dr David Cousins AM, Deputy Monitor
Emergency Services Levy Insurance Monitor
Level 9, McKell Building
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SYDNEY NSW 2000

6 May 2016

Dear Professor Fels and Dr Cousins

GUIDELINES FOR THE REMOVAL OF THE EMERGENCY SERVICES LEVY IN NSW

In order to ensure an effective and harmonious transition from an insurance-based Emergency Services Levy (ESL) to an Emergency Services Property Levy, the Insurance Council of Australia[1] (the Insurance Council) is grateful for the opportunity to comment on the issues experienced with the Victorian guidelines which operated in relation to reform of the Fire Services Levy.

As the Victorian model will be the basis of the guidelines which govern the transition process in NSW, the Insurance Council and its members are keen to work with Treasury and the Monitor to develop solutions which avoid the problems encountered by industry in Victoria. We therefore look forward to meeting the Monitor and Deputy Monitor to discuss the matters raised in this submission.

There are also several differences between the legislative regime which operated in Victoria and that set out in the Bill introduced into the NSW Parliament on 3 May. Consequently, there are a number of aspects of these new provisions which need to be fleshed out and clarified in the NSW Guidelines.

Please refer to the discussion of the issues in the Attachment

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[1] The Insurance Council of Australia is the representative body of the general insurance industry in Australia. Our members represent more than 90 percent of total premium income written by private sector general insurers. Insurance Council members, both insurers and reinsurers, are a significant part of the financial services system. September 2015 Australian Prudential Regulation Authority statistics show that the private sector insurance industry generates gross written premium of $42.8 billion per annum and has total assets of $121.3 billion. The industry employs approximately 60,000 people and on average pays out about $115.6 million in claims each working day.

Insurance Council members provide insurance products ranging from those usually purchased by individuals (such as home and contents insurance, travel insurance, motor vehicle insurance) to those purchased by small businesses and larger organisations (such as product and public liability insurance, professional indemnity insurance, commercial property, and directors and officers insurance).

If you have any questions or comments in relation to our submission, please contact John Anning, the Insurance Council's General Manager Policy, Regulation Directorate, on (02) 9253 5121 or janning@insurancecouncil.com.au.

Yours sincerely

Robert Whelan
Executive Director and CEO

INSURANCE COUNCIL OF AUSTRALIA

ATTACHMENT

ISSUES EXPERIENCED WITH THE VICTORIAN GUIDELINES FOR FSL REMOVAL

GUIDELINES ON PRICE EXPLOITATION

GUIDELINE 4

> Each insurance company is requested to provide to the Fire Services Levy Monitor a declaration signed by the Chief Executive Officer of the company (or equivalent position) stating that the company has implemented internal controls designed to ensure that no FSL will be charged on new policies issued or policies renewed from 1 July 2013. Each declaration received will be published on the Monitor's website.

There were considerable costs for some insurers in providing a CEO signed declaration in relation to the implementation of internal controls as verification required the external audit of processes before the declaration could be made.

Recommendation

Rather than the text required in Victoria, the Insurance Council recommends that use in NSW of a signed declaration committing companies "not to charge ESL on policy renewals or new policies after 30 June 2017" would achieve the same outcome. The commitment would however need to take account of policies incepted in the 2016/17 year but where payment is made by monthly instalments and received after 30 June 2017.

GUIDELINE 5

> An insurance company collecting FSL from policyholders in 2012–13 should not collect a total levy amount in excess of the amount of the statutory contribution to a fire service required from that company.
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> If an insurance company collects an amount of FSL in 2012–13 that is more than the amount it is required to contribute to the MFESB and/or the CFA for 2012–13, it will be expected to refund the amount of over-collection by direct refunds to policyholders or, allowing for the practical difficulties of direct refunds in some circumstances, by other method of disbursement.
>
> The method or formula for allocating refunds or other method of disbursement of an over-collection should be by agreement with the Monitor. Such agreement will be formalised in an enforceable undertaking pursuant to section 92 of the Act.

Members consider that the way in which this guideline simplistically prohibited over collections was unreasonable as it failed to take into account the difficulty companies faced in recovering their statutory contributions. The determination of the ESL rate charged by

members requires a prediction, initially for the full fiscal year, of Gross Written Premiums (GWP) which is then used with the "advanced statutory contribution" ESL rate calculation.

$$ESL\ rate\ \% = \frac{Advanced\ Statutory\ contribution}{Predicted\ Gross\ Written\ Premium} * 100$$

While a company will review their ESL rate calculations at semi-annual or quarterly intervals, where actual GWPs to the date of review are then combined with revised predictions for the remainder of the year it is highly likely that a company will over or under-collect as the GWP in a year will depend on market conditions, both in terms of the actual number of risks insured and the premium charged per risk.

The process is also complicated by the fact that the Advanced Statutory Contribution for a given fiscal year is based on previous year shares of declared premiums and the Final Contribution Payable is not known until the December following the end of the financial year when the Department of Justice has the fiscal year declared contributions. There is the added risk therefore that a company will over or under collect because of changes in market shares that result in a changed share of declared contributions and therefore the individual statutory contribution liability.

The member experience in Victoria was that an over-collection was automatically interpreted as price exploitation. Given the transparency of ESL collection, this is difficult to understand because over collections are to be returned to policyholders or distributed as decided by the Government and Monitor. Over collections in these circumstances do not benefit the insurer.

Recommendation

The Insurance Council respectfully requests the Monitor to recognise the difficulty members face in recovering the exact amount of their statutory contributions through an ESL. All the factors referred to in the monitoring legislation should be considered before an allegation of price exploitation is made. There should in effect be a "safe harbour" from price exploitation provided in the Guidelines where over collection results from efforts made in good faith to recover statutory contributions through the ESL.

Any over collection should also be considered in the context that the Monitor has indicated to insurers that they are permitted to aggregate statutory contribution recoveries for fiscal 2016 and 2017.

MATERIALITY THRESHOLD FOR RETURNING OVER COLLECTIONS TO INDIVIDUAL POLICYHOLDERS

Section 22 of the Guidelines issued under section 6(2) (d) and 27 of the Fire Services Levy Monitor Act 2012 pertaining to the Resolution of Insurers' over-collection of the fire services levy in 2012

Section 22 of the Guidelines pertaining to the Resolution of Insurers' Over-collection of the fire services levy in 2012 set a $20 materiality threshold for the refund of over collections to individual policyholder. Members consider that $20 threshold was too low in view of the considerable cost of processing such refunds. We would appreciate a discussion around the level at which the threshold should be set but a $30 threshold would be more commercially realistic to administer.

The Victorian Guidelines invited insurers to discuss individually with the Monitor a refund threshold for commercial policies. The Insurance Council suggests that setting a common threshold for over collection refunds on commercial policies would be more efficient.

In specifying the treatment for over collections which fall below the minimum threshold for refund, the Insurance Council proposes that insurers pay the money to the NSW Government to be used for funding the emergency services. This is logical given the purpose for which the money was collected in the first place.

Recommendation

The Insurance Council recommends that:

- Discussions with industry take place on the level of the thresholds for returning over collections in relation to both household and commercial policies. $30 is suggested as an appropriate level for household policies; and
- over-collections which fall below the minimum threshold for refund be paid to the NSW Government for the funding of the emergency services.

GUIDELINE 6

Factors relevant to assessing whether the premium component of a price is unreasonably high are: the reasonable costs of all business inputs involved in a company's supply of fire insurance, including expenses incurred in the normal course of operating places of business; and costs incurred in re-insurance arrangements relating to the provision of fire insurance. In assessing whether a price is unreasonable, there will be a particular focus on any change in methodology. Where a company incorporates a new factor (or factors) in its pricing methodology for 2013–14, and this factor contributes to an increase in prices in 2013–14, the Monitor expects the company to provide an explanation of the methodology change.

The experience of members was that the Monitor's request for data explaining pricing methodology with specific reference to flood and fire risks over three separate periods during the transition year in Victoria was onerous and unnecessarily accrued considerable costs to member companies. Furthermore, the request was a blanket request and was therefore considered unnecessary by a number of companies who felt they did not violate this guideline.

Recommendation

While acknowledging the right of the Monitor under the proposed legislation to look at changes in pricing methodology, the Insurance Council submits that the NSW Guidelines should stipulate that the Monitor's requests of information should be reasonable in relation to the administrative burden placed on insurers.

GUIDELINE 9

Premiums for new policies issued in 2013-14 should be determined on the same methodology as premiums for existing policies being renewed in2013-14.

Depending on circumstances, insurers may adjust their pricing methodologies a number of times during a year. It would be unrealistic and commercially detrimental to expect insurers to hold to the same pricing methodology for two financial years.

Recommendation

The Insurance Council recommends the NSW guidelines recognise the need for insurers to adjust their pricing methodology as needed commercially.

GUIDELINE 10

An insurance company that retains any revenue that was collected as FSL through premiums for domestic building and contents policies will be expected to refund a pro-rata portion of that revenue to a policyholder who cancels the regulated contract of insurance before 1 July 2013 and:

- the cancellation results in a reduction in the liability of the insurance company to contribute to the fire services; and
- an invoice for a regulated contract of insurance sent by the company relating to coverage of any period in the 2012–13 financial year specifically identifies that a component of the price is attributable to FSL (howsoever described);

or

- the company withholds, or represents that it is withholding, an amount of money from a refund of premium to a customer on the basis that it is required as a contribution to the fire services.

The Insurance Council submits that it is reasonable for a company to retain the unearned ESL component of a premium when a policy holder cancels a policy incepted in 2016-17

around the end of 2016/17 or early in 2017/18. This will be necessary in order to deter "gaming" whereby a policyholder cancels their insurance contract in order to obtain a pro-rata refund ESL paid and then take out another policy on or after 1 July 2017 when ESL is not payable.

Retention of ESL is also consistent with the separation of the "emergency services cover period" and the "insurance cover period".

An insurance company's contribution to the funding of the emergency services is made on a financial year basis, where the budget being funded is a financial year budget and an individual company's share of the statutory contribution is based on its share of the declared premium for the same financial year.

Consequently, the portion of the premium collected to recover a company's statutory contribution should be seen as funding for an "emergency services cover period" which is the financial year in which the policy is incepted.

In contrast the insurance cover period is the twelve month period from inception of the policy.

As a consequence, a policy holder that currently renews a policy on 1 July is paying 12 months in advance for both emergency services and insurance cover while a policyholder that renews a policy on 30 June is paying for emergency services cover twelve months in arrears and 12 months in advance for insurance cover.

The Insurance Council notes that the separation of the emergency services cover period was recognised by the Victorian FSL monitor and explained in the publication "The Levy" it posted on its web site.

The Insurance Council also points out the application of Guideline 10 in NSW is impracticable because;

- the requirement that a company refunds unearned ESL if a cancellation results in a reduction in the liability to contribute to the fire services cannot be determined at the time of cancellation because the final contribution liability is not made until December after the end of the financial year; and
- the requirement a company refund unearned ESL if it specifically identified that a component of the price is attributable to FSL will make it compulsory for a company to refund the unearned ESL because it is a legislative requirement in NSW that a company identify the ESL component on an invoice.

Recommendation

The NSW guidelines should allow companies to withhold the unearned ESL where policyholders cancel policies incepted in 2016/17 towards the end of that financial year provided an explanation/clause to this effect is included in Product Disclosure Statements.

LEVY ISSUES RELATED TO DELAYED PROCESSING

Section B.9 Particular circumstances arising from the 30 June 2013 end-date of statutory contributions.

Members have expressed concern that, while section B9 addressed the issue of 'delayed processing' in the Victorian guidelines, it did not adequately account for intermediated insurance business. Members were concerned that where a broker placed business with a policyholder and issued documents prior to the 30 June cut-off date but notified the insurance company post the cut- off date then an offence would be incurred under Guideline 3 of the Monitor's Guidelines on False Representation or Misleading or Deceptive Conduct and Guideline 3 of the guidelines on Price Exploitation.

Recommendation

The Insurance Council recommends the NSW guidelines explicitly address the role of intermediated business as a particular circumstance arising from a 30 June end date.

GUIDELINES ON FALSE REPRESENTATION OR MISLEADING OR DECEPTIVE CONDUCT

GUIDELINE 2

> To reduce risks of engaging in false representation or misleading or deceptive conduct in contravention of Section 31 of the Act, an insurance company should provide easily accessible and comprehensible information to its customers on the abolition of the FSL and how their premiums for policy renewals are set to take account of its abolition.
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> A policyholder requesting information on the removal of FSL from a premium for renewal of a policy, and/or an explanation of any increase in premium concurrent with the apparent removal of FSL, should be provided with information specific to the particular policy. The information should be sufficient to enable the policyholder to assess the reasonableness of the premium being charged.

The Insurance Council and members understand Guideline 2 as it operated in Victoria. However, there is confusion whether the explanatory material it required will in NSW be contained in the prescribed notice that we understand NSW Treasury is preparing and which will be required to be distributed with communications to customers containing premium information. Industry submits that the two sets of information need to be totally separate otherwise consumers may be confused by slightly different wordings of the same message.

Confusion about the content of the prescribed notice needs to be resolved immediately as insurers are now in the process of finalising their communications for renewals which fall in June 2016.

Recommendation

The text of the prescribed notice must be agreed with industry and finalised immediately. (See section below specifically on prescribed notice.)

GUIDELINE 4

An insurance company that provides a policyholder with the following information regarding the renewal of a policy in 2013–14:

- the amount of FSL, GST and duty on the FSL paid for the policy during 2012–13; and
- the base premium paid on the policy during 2012–13; and
- the total amount of premium, including base premium and fire services levy, and GST and duty paid on the policy during 2012–13;
- the total amount of premium, GST and duty payable on the renewal issued during 2013–14; and
- an explanation of the reason for any change in base premium payable in 2013–14

will be less likely to be considered to have contravened section 31 of the Act than otherwise.

Many companies commenced charging zero FSL prior to the end of the 2012–13 financial year due to the tapering of FSL rates raising sufficient revenue to meet their estimated funding obligations to the fire services for 2012–13. Given this situation, an insurance company that provides a policyholder with the following information regarding the renewal of a policy where a zero FSL is charged prior to 1 July 2013:

- the amount of FSL, GST and duty on the FSL paid in the preceding premium; and
- the base premium paid on the policy in the preceding premium; and
- the total amount of premium, including base premium and fire services levy, and GST and duty paid in the preceding premium;
- the total amount of premium, GST and duty payable on the renewal issued prior to 1 July 2013; and
- an explanation of the reason for any change in base premium between the two

will be less likely to be considered to have contravened section 31 of the Act than otherwise...

The Monitor's Guidance Statement and discussion to date have led the Insurance Council and its members to understand that the Monitor wants companies ideally to provide a premium comparison for the years 2015/16 and 2016/17 on new policies and policy renewals with an inception date between 1 July 2016 to 30 June 2017 inclusive, and that this comparison be printed on renewal notices or invoices.

This approach creates significant timing and practicable problems for insurers given renewal notices must be issued at least six weeks before a policy expires and are already in preparation for policies which will be affected by levy changes. Importantly, a significant number of insurers have indicated to the Insurance Council that because of systems limitations they are not able to print the current and previous year's premiums on an invoice or can only do so on selected product lines.

The Insurance Council submits the intention should be at the end of the transition year to demonstrate to policyholders that removal of the ESL has been passed on to them. This

would only require comparison of the premium for 2016-2017 with that applying in 2017-2018.

Recommendation

The Insurance Council recommends:

- The premium for 2016-2017 be available for comparison with that applying in 2017-2018.
- The Monitor accept alternative methods of providing premium comparisons other than printing both years' premium amounts on the renewal notice. The Insurance Council recommends these alternatives be agreed on a company by company basis.

NEED FOR GUIDELINES ON NEW PROVISIONS IN NSW MODEL

PUBLIC INQUIRIES

27 Inquiries

(1) The Monitor may conduct an inquiry into any matter relating to prohibited conduct in the insurance industry that the Monitor considers to be of significance to the public.

(2) An inquiry may be conducted under this Division in respect of a particular insurance company, or insurance companies generally.

(3) An inquiry may be held in public or in private.

Given the damage which can be done to an insurer's reputation through allegations of price exploitation, the Insurance Council strongly submits that there must be clear guidelines as to when a public inquiry can be held into a matter relating to prohibited conduct.

As required in section 31 of the Bill in relation to public warning statements, the Monitor should explain why a public hearing is in the public interest. The Insurance Council submits that there should be strong evidence of intentional wrongdoing for commercial profit before a public inquiry could be justified.

Recommendation

The Insurance Council submits that:

- there must be clear guidelines as to when a public inquiry can be held into a matter relating to prohibited conduct; and
- a public inquiry should only be held in light of strong evidence of intentional wrongdoing for commercial profit.

PRESCRIBED NOTICES

30 Notice relating to emergency services levy reform

(1) The Monitor may publish a notice in the Gazette containing such information as the Monitor considers appropriate to inform the public of the emergency services levy reform and the functions of the Monitor under this Act.

(2) If an insurance company or person acting on behalf of an insurance company issues to a person an invoice or other statement as to the price payable for the issue of a regulated contract of insurance, the insurance company, or person, who issues the statement must ensure that the statement includes the information contained in the notice published under subsection (1).

Maximum penalty: 200 penalty units.

(3) For the purposes of subsection (2), the ***issue of a regulated contract of insurance*** includes the renewal of an existing regulated contract of insurance, but does not include the variation of an existing regulated contract of insurance.

When discussing the drafting of this section with Treasury, it was agreed that the prescribed notice need only be provided once. However, the industry is concerned that the text of the Bill will result in the notice being required to be provided with statements such as quotes which have information on price payable. Receiving multiple copies of the same notice would obviously be annoying to consumers and an unnecessary cost for insurers. The Insurance council therefore requests that the Monitor issue guidance which clarifies that a prescribed notice need only be provided once on renewal or new business.

As explained above in relation to material explaining the impact of ESL reform to consumers, industry is very concerned at the scope for consumer confusion if the text of the prescribed notice is not settled immediately. This will enable insurers to develop their customer communications with certainty. Even so, given that six to eight weeks is needed to implement changes to customer correspondence, there needs to be a realistic period allowed between gazettal of the prescribed notice and when its inclusion is required.

Recommendation

The Insurance Council urges that:

- the Monitor issue guidance which requires a prescribed notice to be provided only once on renewal or new business;
- the text of the prescribed notice be settled immediately; and
- a realistic period of eight weeks be allowed between gazettal of the prescribed notice and when its inclusion is required.