INSURANCE COUNCIL OF AUSTRALIA

Mr Anthony Johnston
Commissioner of State Revenue
NSW Office of State Revenue
The Lang Centre, 132 Marsden Street
PARRAMATTA NSW 2150

12 August 2016

Dear Mr Johnston

TREATMENT OF GAP INSURANCE POLICIES

The Insurance Council of Australia[1] (the Insurance Council) is writing in response to a recent interpretation by the NSW Office of State Revenue of (OSR) as to how Section 233 of the *Duties Act 1997* NSW (the Act), which divides general insurance for the purpose of charging duty, applies to a type of cover available for motor vehicles.

From some of its members, the Insurance Council understands that the OSR has taken a view that gap cover insurance policies (gap insurance) issued by those members should be treated as "*Type A insurance*" under subsection 233(2) of the Act, attracting 9 per cent duty.

On this view, the OSR considers that the event that gives rise to the loss covered under a gap insurance policy strictly relates to the *liability* under a motor vehicle loan agreement, and that the loss of the motor vehicle is not the event covered by a gap insurance policy.

The approach that the OSR has put to several of our members is that insurance covering the loss of a motor vehicle does not extend to a *liability arising* from the loss of a motor vehicle, as this is a consequence of the loss of the motor vehicle itself, and on that basis, should not be treated as "*Type B insurance*", as provided under paragraph 233(2A)(a) of the Act:

> " *… (a) motor vehicle insurance, being insurance covering any one or more of the following:*
>
> *(i) the loss (including the loss by theft) of a motor vehicle,*
>
> *(ii) damage to a motor vehicle,*
>
> *(iii) loss of or damage to property by a motor vehicle …* "

The Insurance Council disagrees with the OSR's interpretation.

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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. March 2016 Australian Prudential Regulation Authority statistics show that the private sector insurance industry generates gross written premium of $43.8 billion per annum and has total assets of $118.5 billion. The industry employs approximately 60,000 people and on average pays out about $124.2 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).

Firstly, we consider that the OSR's position conflicts with the general principles of statutory interpretation. We note that there is no evidence that the term "*covering*" under the Act is limited to only capture the physical loss of a motor vehicle itself. However, we believe that the relevant case law[2] supports the term "*covering*" being construed in a broader sense, and, therefore, that regard to this should be had in interpreting the term "*covering*" under the Act.

Accordingly, it is inappropriate to construe the term "*covering*" under the Act so narrowly as to exclude *liability* arising as a consequence from a loss of a motor vehicle, unless that was the clear stated intention of the government at the time that the provisions were introduced.

On this basis, the Insurance Council submits that insurance covering the loss of a motor vehicle, for the purposes of the Act, appropriately extends to covering for losses that may arise as a consequence of the loss of a motor vehicle (e.g. insurance covering for gap liability, hire car costs, travel costs and loss of personal items).

Furthermore, the OSR's interpretation conflicts with established market practice of many Insurance Council member insurers. For these insurers, it is customary that, where a consumer purchases comprehensive motor vehicle insurance that includes gap insurance, no separate premium is payable; the premium is underwritten on an aggregated basis to include a value for gap insurance and potentially other optional motor vehicle covers.

In this regard, the OSR's interpretation would create uncertainty and complexity, leading to unnecessary administrative costs for insurers and, ultimately, higher motor vehicle insurance prices for consumers. Indeed, to depart from established practice without good reason runs the risk of inefficiency and confusion.

For these reasons, the Insurance Council submits that it should be accepted that gap insurance falls under paragraph 233(2A)(a) of the Act and is "*Type B insurance*". As the OSR would be aware however, while some of our members have recently commenced treating their gap insurance policies as Type A insurance, they disagree with this approach and have done so reluctantly.

It is unfortunate that this has created inconsistency and a high level of uncertainty across the general insurance industry. To expedite a decisive resolution to this industry-wide concern, the Insurance Council requests an opportunity to meet with you to discuss this matter in detail and will contact your office to arrange a suitable time.

In the interim, please contact John Anning, the Insurance Council's General Manager Policy, Regulation Directorate, on tel: (02) 9253 5121 or email: janning@insurancecouncil.com.au if your require further information.

Yours sincerely

Robert Whelan
Executive Director and CEO

[2] *AMP Life Limited v Commissioner of State Revenue* (VIC) [2003] VSC 198.

INSURANCE COUNCIL OF AUSTRALIA

ATTACHMENT

REASONS WHY THE OSR'S INTERPRETATION IS MISTAKEN

Statutory Interpretation

The Insurance Council notes that the liability for duty of these policies appears to be a question of statutory interpretation of key terms in paragraph 233(2A)(a) of the Act that are not defined within that Act – particularly the term "*covering*".

Subsection 34(1) of the *Interpretation Act 1987* (NSW) provides that in interpreting an Act or statutory rule, regard should be given to extrinsic materials that are capable of assisting in the ascertainment of its meaning:

> *"In the interpretation of a provision of an Act or statutory rule, if any material not forming part of the Act or statutory rule is capable of assisting in the ascertainment of the meaning of the provision, consideration may be given to that material… to determine the meaning of the provision … if the provision is ambiguous or obscure, or … if the ordinary meaning conveyed by the text of the provision … leads to a result that is manifestly absurd or is unreasonable."*

However, it is not clear that the OSR has had regard to any extrinsic materials that are capable of assisting in the ascertainment of the meaning of key terms provided under paragraph 233(2A)(a) of the Act.

The term "*covering*" was considered in *AMP Life Ltd v Commissioner of State Revenue* [2003][3] in the context of the definition of a policy in the former Victorian Stamps Act 1958.

The Supreme Court of Victoria considered that the word *"covering"* is a very general word and observed the definition of "*cover*" in the Oxford English Dictionary which included the following:

- to be extensive enough to include or comprehend;
- to include within its application or scope; to provide for;
- to include, comprise, extend over; or
- to extend over, be co-extensive with, occupy, comprise.

The Supreme Court of Victoria then held that:

> "… *the common fact is that the thing that covers is at least co-extensive with the thing which is covered; cover indicates inclusiveness, not exact correspondence* …".

On this basis, the Insurance Council believes that insurance covering the loss of a motor vehicle, for the purposes of paragraph 233(2A)(a) of the Act, extends to covering a consequential loss from the happening of that event.

As there is no evidence that the term "*covering*" under the Act is limited to the physical loss of a motor vehicle itself, it is inappropriate to construe the term "*covering*" so narrowly as to exclude covering for a liability arising from a loss of a motor vehicle, unless that was the clear stated intention of the government at the time that the provisions were introduced.

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[3] *AMP Life Limited v Commissioner of State Revenue* (VIC) [2003] VSC 198.

In addition, if the term "*covering*" under the Act was intended to be limited to the physical loss of a motor vehicle itself, certain aspects of some comprehensive motor insurance policies – such as cover for hire car costs, travel costs and costs of damaged personal items – would not fall under paragraph 233(2A)(a) of the Act, as these policies also provide cover for losses that arise as a consequence of the loss of (or damage to) a motor vehicle.

For instance, the payment for a hire car costs is only made when there is a loss (or damage) to an insured's motor vehicle; payment is made as a consequence of the insured event (i.e. the loss or damage to an insured's motor vehicle) and is an additional payment because of the loss or damage to the insured's motor vehicle.

Furthermore, it is usual market practice that gap insurance policy documents clearly state that the policy relates to a 'total loss of a motor vehicle'; therefore, gap insurance policies contain words that accord with paragraph 233(2A)(a) of the Act.

Predecessor Legislation

The Insurance Council considers that it is instructive to also consider the overarching intent of paragraph 233(2A)(a) of the Act. In NSW, the predecessor to paragraph 233(2A)(a) of the Act was section 86(1) of the Stamp Duties Act 1920 (NSW), which was introduced in 1989 under the Stamp Duties (Amendment) Act 1989 No. 113[4] by inserting:

> "… *"Class 2 insurance" means:*
>
> *(a) motor vehicle insurance, being insurance covering any one or more of the following:*
>
> *(i) the loss (including the loss by theft) of a motor vehicle,*
>
> *(ii) damage to a motor vehicle,*
>
> *(iii) loss of or damage to property by a motor vehicle* …"

This was one of a suite of changes introduced by the Stamp Duties (Amendment) Act 1989 No. 113 to the stamp duty regime in NSW in order to bring it into line with other States and Territories by assessing duty on the basis of a percentage of premiums received rather than on each policy being individually assessed as a percentage of the sum insured.

The previous system had been criticised as being time consuming and the new system was praised in parliament as it would provide savings in administrative costs for insurers as well as simplifying audit procedures for the OSR.

Significantly, the parliamentary debates[5] make it clear that the amendments regarding stamp duty charged on motor vehicle insurance were intended to facilitate jurisdictional uniformity:

> "… *brings New South Wales into line with the rest of Australia* …" and "… *ensuring harmony and, more important, uniformity in relation to stamp duty*."

The relevant provisions of section 86(1) of the former Stamp Duties Act 1920 (NSW) is the same wording as the current paragraph 233(2A)(a) of the Act.

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[4] Stamp Duties (Amendment) Act 1989 No. 113 (NSW) – Schedule 1 – Amendments relating to insurance

[5] Stamp Duties (Amendment) Bill 1989, second reading speech to the NSW Legislative Council on 2 August 1989 by the Hon. Edward Pickering, former Minister for Police and Emergency Services and Vice-President of the Executive Council; and statement by the Hon. John Matthews, former Member of the NSW Legislative Council.

On this basis, the Insurance Council submits that the OSR's interpretation of paragraph 233(2A)(a) of the Act conflicts with the still relevant policy intent of that paragraph. It is critical that the key reasons behind the legislation – including the intention to facilitate jurisdictional uniformity – are upheld. If the OSR continues to see merit in pursuing its interpretation, it should justify why it would be beneficial to depart from an approach that is inconsistent with other State and Territory jurisdictions.

Insurance Contracts Regulations

A Panel of the Insurance Ombudsman Service[6] (the Panel) has held[7] that a "*Gapcover Policy*" (the terms of which are similar to gap insurance) is within the definition of "*motor vehicle insurance*" under Regulation 5 of the *Insurance Contracts Regulations 1985* (Cth):

> "… *(a) loss of, or damage to, a motor vehicle;*
>
> *(b) liability for loss of, or damage to, property caused by or resulting from impact of a motor vehicle with some other thing…* "

The Panel was concerned with whether the "*gapcover policy*" provided for payment on the event of a loss or damage to a motor vehicle, which appears consistent with the OSR's concern with gap insurance for the purposes of paragraph 233(2A)(a) of the Act.

The Panel concluded that a "*gapcover policy*" was within the definition of "*motor vehicle insurance*" in Regulation 5, on the basis that the policy provided insurance cover only when:

- loss or damage to a motor vehicle had been sustained; and
- the subject vehicle must have been covered by a comprehensive insurance policy as a condition precedent of the gapcover policy.

The Insurance Council considers that this determination supports our submission that gap insurance falls under paragraph 233(2A)(a) of the Act and is therefore "*Type B insurance*".

Established Market Practice

The Insurance Council emphasises that, for many of its member general insurers, where a consumer purchases gap insurance with their motor vehicle insurance, no separate premium is payable.

For these member insurers, while gap insurance may be treated as an 'optional cover', it does not attract a specific premium allocation. Where a consumer purchases a level of comprehensive motor vehicle insurance that includes gap insurance, the premium for the comprehensive motor vehicle insurance is underwritten on an aggregated basis to include a value for gap insurance.

For these insurers, the cost of systems changes required to accommodate a completely different approach to imposing stamp duty on gap insurance, and indeed other motor vehicle insurance, would be significant and not commercially viable.

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[6] Now part of the Financial Ombudsman Service.
[7] Determination by the Panel of the Insurance Ombudsman Service (Referral Number: 302 08 15940); the referral concerns the extent of cover of motor vehicle gap insurance.

This would unduly constrain the commercial activities of these insurers and deter investment in measures that support consumer welfare, such as initiatives which enhance product/service quality and support competitive pricing and consumer choice.

We consider that the cost of upfront system changes would far exceed the amount of any duty revenue that may be raised. Indeed, the OSR may itself incur substantial costs directly related to the administration of its own interpretation, and these costs alone may exceed any revenue that may be raised.

For these reasons, the Insurance Council submits that any departure from established industry practice should be undertaken with an awareness of the likely consequential inefficiencies.

Detriment to Consumer Welfare

The Insurance Council submits that the OSR has failed to take account of the detrimental impact that its interpretation of paragraph 233(2A)(a) of the Act would have on consumers.

The OSR's interpretation would lead to unwarranted higher premiums for comprehensive motor vehicle insurance that include gap insurance; in part, from the higher "*Type A insurance*" stamp duty, but chiefly from the significant compliance costs associated with systems implementation and maintenance.

Policy Rationale for Change

Any proposed changes to taxation policy should be underpinned by a thorough cost-benefit analysis within a broader process where all stakeholders generally can be seen to benefit from an outcome that promotes the wider community interest. Undertaking this analysis would ensure that there is a net community benefit to be derived from the policy change, and that a net efficiency loss for the community is not generated.

However, it does not seem that the OSR has performed any analysis of the potential impact of its interpretation. We consider that it is important for the OSR to be able to clearly demonstrate to the community how its interpretation would deliver a net benefit.

Accordingly, the OSR should complete a cost-benefit analysis of the potential impact of its interpretation. If there is any benefit to the community to be gained, the OSR should clearly explain how this outweighs the significant costs. However, the Insurance Council submits that performing such an analysis would reveal that the total costs far exceed any benefits that may be identified.